

### EU Trade Policy Reform: Levelling the Playing Field in a New Geo-Economic Environment

Schmucker, Claudia; Mildner, Stormy-Annika

Veröffentlichungsversion / Published Version  
Arbeitspapier / working paper

#### Empfohlene Zitierung / Suggested Citation:

Schmucker, C., & Mildner, S.-A. (2020). *EU Trade Policy Reform: Levelling the Playing Field in a New Geo-Economic Environment*. (DGAP Analysis, 7). Berlin: Forschungsinstitut der Deutschen Gesellschaft für Auswärtige Politik e.V..  
<https://nbn-resolving.org/urn:nbn:de:0168-ssoar-71274-8>

#### Nutzungsbedingungen:

Dieser Text wird unter einer CC BY-NC-ND Lizenz (Namensnennung-Nicht-kommerziell-Keine Bearbeitung) zur Verfügung gestellt. Nähere Auskünfte zu den CC-Lizenzen finden Sie hier:  
<https://creativecommons.org/licenses/by-nc-nd/4.0/deed.de>

#### Terms of use:

This document is made available under a CC BY-NC-ND Licence (Attribution-Non Commercial-NoDerivatives). For more information see:  
<https://creativecommons.org/licenses/by-nc-nd/4.0>

---

# EU Trade Policy Reform

## Levelling the Playing Field in a New Geo-Economic Environment



**Dr. Claudia Schmucker**  
Head, Geo-Economics  
Program, DGAP



**Dr. Stormy-Annika Mildner**  
Head, Department  
External Economic Policy,  
Federation of German  
Industries (BDI); External  
Lecturer Hertie School of  
Governance; and Designated  
Director of Aspen Germany

Today, trade policy is used more and more often to achieve geopolitical goals. To defend European interests in this new geo-economic environment, the EU must recalibrate its unilateral, bilateral, and multilateral trade toolbox. While the EU needs to counter the increasingly unlevel international playing field, self-sufficiency is not a viable option. The strength of the EU depends on its openness and integration in world markets.

- **The Unilateral (EU) Dimension:** The EU needs to be assertive in the application of its trade defense instruments. While the 2018 reform of antidumping measures was a good start, the EU also needs to strengthen and supplement other instruments – particularly countervailing measures to address foreign subsidies as well as the EU's Enforcement Regulation.
- **The Bilateral Dimension:** It would be wrong to only focus on the unilateral and defensive side of trade policy. The EU also needs to push ahead with bilateral free trade agreements to open foreign markets and to help shape globalization and rules-based trade. The ratification and utilization of such FTAs need to be improved.
- **The Multilateral Dimension:** Predictable and transparent rules and their enforcement are indispensable for the EU. Thus, the EU should intensify its efforts – together with like-minded countries – to modernize the rule book of the WTO. It should pursue plurilateral agreements on e-commerce and possibly industrial subsidies, improve the WTO notification requirements through counter-notifications, and reform its dispute settlement mechanism.

## EXECUTIVE SUMMARY

Open Strategic Autonomy is the EU's new trade paradigm. European Commission President Ursula von der Leyen wants to reposition the EU in a changed geo-economic environment. Protectionism, state interventionism, and national go-it-alone strategies are *en vogue*. In addition, trade policy is increasingly used to achieve geopolitical objectives. The European Union can no longer rely on traditional partners such as the United States; China has become a systemic competitor. Meanwhile, the World Trade Organization (WTO) is in deep crisis.

Given the changing nature of the trade policy environment worldwide, the European Commission rightly initiated a review of the EU's trade policy instruments. The EU needs to be sufficiently equipped to counter unfair trade practices that harm EU producers at home and abroad. Without doubt, some of the existing instruments require sharpening and new instruments have to be created. At the same time, self-sufficiency is not a viable option. Protectionism would cost jobs, income, and wealth and lead to greater income inequality. The EU should pursue an active, liberal trade policy that clearly aligns trade defense measures with Union interests. Trade policy should not primarily be used as a lever for other policy objectives. In addition, the European Union needs to be careful not to further undermine the multilateral trading system by establishing unilateral instruments that are not compatible with WTO rules.

Thus, while the wider public focuses primarily on the defensive side of trade policy – the unilateral dimension at the EU level – it would be shortsighted to neglect the bilateral and multilateral dimension. All three dimensions work hand in hand and cannot be separated when discussing possible changes to EU trade policy. In our analysis, we recommend the following reforms to these three dimensions:

## THE UNILATERAL (EU) DIMENSION

**1. ANTIDUMPING MEASURES (AD):** EU antidumping measures are an important tool to protect European producers from unfair competition from abroad. The 2018 reform of the AD Regulation was of great importance. Therefore, before reforming the AD toolkit again, a detailed analysis of its effectiveness should be carried out first – including consultations with all relevant stakeholders. Possible reform measures include the following: The Commission should assist companies in establishing the necessary evidence for dumping by publishing further reports about price

distortions in third countries. Procedures should be further streamlined to lower administrative costs to help small companies. Furthermore, the Commission should more often pursue antidumping and anti-subsidy investigations in parallel. Lastly, an extension of the antidumping instruments to trade in services should be examined.

### 2. COUNTERVAILING (ANTI-SUBSIDY) DUTIES:

The WTO rules on subsidies, embedded in the General Agreement on Tariffs and Trade (GATT) and the Agreement on Subsidies and Countervailing Measures (SCM Agreement), are weak. The EU should pursue multilateral, plurilateral (in the best case, under the WTO), and bilateral efforts (such as in free trade agreements) to develop better disciplines on industrial subsidies and state-owned enterprises, and to strengthen notification disciplines. The proposals of the Trilateral Initiative (the EU, Japan, and the United States) on appropriate rules is a step in the right direction. The EU should also reform its countervailing measures (CVM). The framework for CVMs should be strengthened and its application should be facilitated. In the future, CVMs should be designed in a way that allows them to more fully address the market-distortive effects of foreign state-owned enterprises (SOEs).

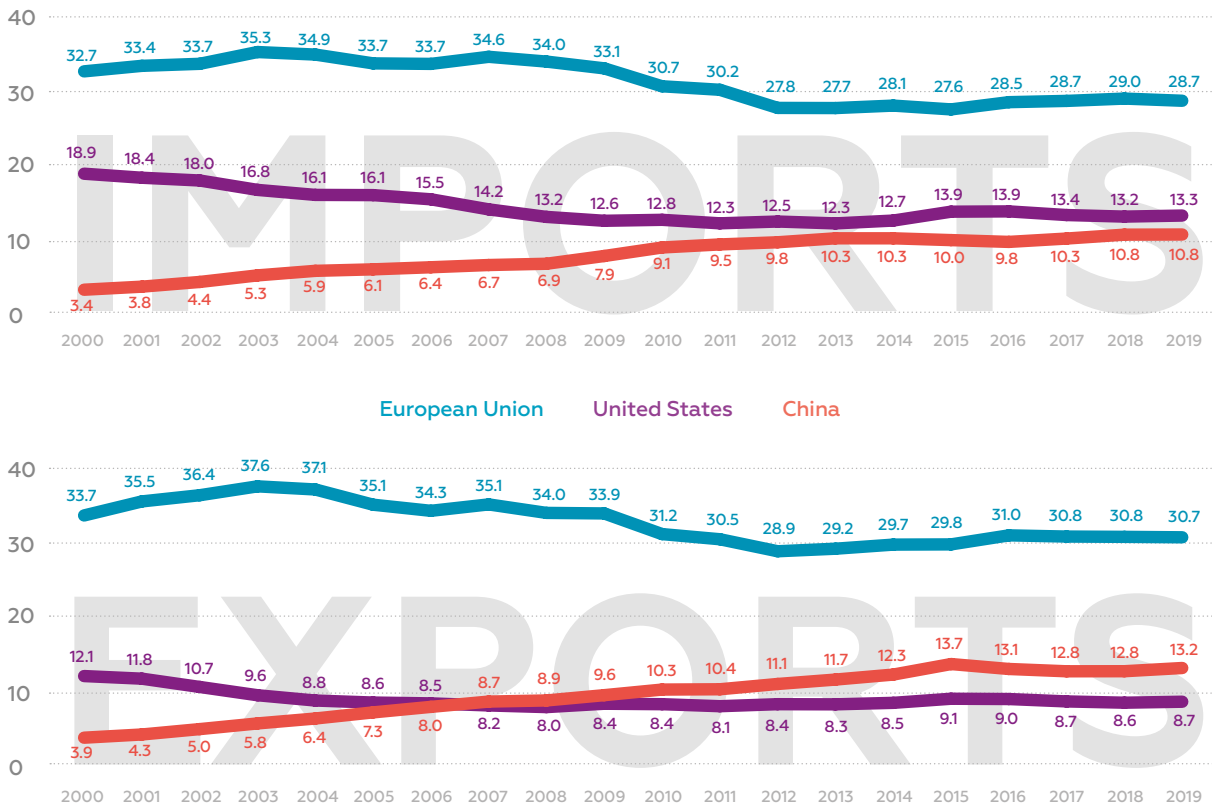
### 3. ENFORCEMENT REGULATION AND CHIEF TRADE ENFORCEMENT OFFICER:

The amendment to the EU's Enforcement Regulation is indispensable to ensure that the EU can deal effectively with trade conflicts. If a country is not willing to engage in mediation after a WTO panel report, the EU needs to be able to retaliate in order to ensure a level playing field and fair competition. Still, the first priority must always be the reform of the multilateral dispute settlement system. The newly established Chief Trade Enforcement Officer (CTEO) can also help strengthen the position of the European Union by, for example, monitoring trade agreements by partner countries. The CTEO should be given a clear and transparent mandate and sufficient resources.

### 4. EXPORT CONTROLS FOR CRITICAL PRODUCTS

**DURING CRISES:** Export controls – even if they are compatible with WTO rules – are not the right way to address alleged shortages in critical products with complex value chains. Instead, a policy is needed that secures and strengthens global supply chains for protective gear and medical goods. To increase resilience, the EU should thoroughly analyze vulnerabilities in critical supply chains. Further measures include diversification of supply at the country and company level

## SHARE OF WORLD TRADE IN GOODS, 2000–2019, IN % IMPORTS (TOP) AND EXPORTS (BOTTOM)



Source: WTO, Total Merchandise Trade, in Millions of US Dollars, Current Price, EU Trade Including Intra-EU Trade: <<https://data.wto.org/>>

as well as strategic reserves and stockpiling. In addition, the EU should push the G20 countries to eliminate customs duties on pharmaceutical products and intermediate products as well as medical products in an unbureaucratic, comprehensive, and lasting manner.

**5. INTERNATIONAL PROCUREMENT INSTRUMENT (IPI):** The IPI is a useful tool to give the EU more leverage to achieve more reciprocity in government procurement. The Commission's current IPI proposal needs to be further revised, however, to avoid negative implications for the procurement process. Thus, the leverage effect vis-à-vis third countries should be strengthened, for example by more effective price penalties. At the same time, excessive bureaucratic costs and legal uncertainty for EU companies and contracting authorities, as well as legal uncertainties and risks regarding penalties, must be avoided.

The EU also needs to ensure that the IPI does not result in a worsening of relations with partner countries. Overall, the IPI needs to be balanced, non-protectionist, and compatible with the rules and principles enshrined in the WTO's Government Procurement Agreement (GPA).

**6. COUNTERING EXTRATERRITORIALITY OF SANCTIONS:** For years, the EU has struggled with the extraterritorial reach of sanctions and export controls of the United States. Extraterritorial sanctions harm the economic and foreign policy sovereignty of the EU and impair the global competitiveness of the European economy. The EU therefore needs to sharpen its tools to counter extraterritorial sanctions. The use of the EU's blocking statute is an important political signal. The EU should, however, examine the effects in greater detail in order not to harm European companies in the end.

## EXECUTIVE SUMMARY

The EU should also create an instrument that ensures access to essential export-related services, in particular for the processing of payments. To ensure the effectiveness of such a payment mechanism, a critical mass of EU member states should join. At the center of the EU's ability to counter extraterritorial sanctions stands the role of the euro in the international payment system. To strengthen its use and make the European Union less dependent on the US dollar, the EU needs to advance its financial sector reforms, push forward further economic integration, and strengthen its attractiveness by investing more in the competitiveness of its economy.

**7. INVESTMENT SCREENING:** The European Union greatly benefits from foreign direct investment (FDI). Government interventions are justified to protect national security and public order. But investment screening needs to be proportionate and not create uncertainties and unjustified infringements in private property. Situations in which the state can and should intervene need to be clearly defined. Political measures should by no means encourage the international trend toward investment protectionism. EU member states should inform each other about investment restrictions and more thoroughly coordinate their efforts.

**8. BORDER ADJUSTMENT MEASURES (BAM):** In early March 2020, the Commission proposed a European Climate Law as part of the so-called EU Green Deal. That law proposes a legally binding target of net zero greenhouse gas emissions by 2050. This goal also has a trade dimension. To ensure that EU industry is not put at a disadvantage vis-à-vis foreign producers, the Commission proposes to implement BAMs for greenhouse gas-intensive goods from countries that have implemented no or insufficient climate protection measures. Carbon Border Adjustments should only be implemented under the strict proviso that WTO compatibility and practicability are guaranteed. A careful and comprehensive impact assessment is indispensable. The Commission should also evaluate alternative instruments against carbon leakage. Furthermore, support for the transformation of industry is key.

## THE BILATERAL DIMENSION

**9. CONCLUSION AND IMPLEMENTATION OF FREE TRADE AGREEMENTS (FTAs):** The EU's comprehensive FTAs with strategic partners have both positive economic and geostrategic effects. They also help to shape globalization by establishing modern trade rules in the absence of multilateral rules. In order

to preserve the EU's leverage, however, the cohesion of its trade policy is crucial. It is also important that concluded FTAs are ratified and implemented in a more timely manner. In order to facilitate ratification, EU-only trade agreements (i.e. FTAs that fall into the exclusive competence of the EU level) are the right way forward. In order to improve the utilization rate of FTAs, the EU should negotiate simple and standardized rules of origin. In addition, the European Commission must make sure that no sensitive data must be revealed to foreign entities to verify that a product falls under the agreement. The EU should also deepen some of the existing chapters of its FTAs – first and foremost those on digital trade.

## THE MULTILATERAL DIMENSION

**10. THE MULTILATERAL AGENDA – REFORMING THE WTO:** Reforming the WTO must remain a top priority for the European Union. The most pressing issue is reestablishing a functioning dispute settlement system. The multi-party interim appeal arbitration arrangement (MPIA) is an important step in upholding the rules-based trading system – but it is only a temporary solution. In addition, WTO rules need to be strengthened, in particular on subsidies. Market distortion and overcapacity through government subsidization should be avoided in all cases. Plurilateral agreements within and outside of the WTO – such as those currently negotiated on digital trade; services; investment; and micro, small, and medium-sized enterprises (MSMEs) – are a viable option to advance the global trade rule book. Last but not least, the EU needs to double its efforts to encourage emerging market economies such as China to “graduate” and opt-out of the special and differential treatment.

---

# Contents

<b>1. Introduction</b>	<b>1</b>
<b>2. Open Strategic Autonomy: The EU's New Trade Policy</b>	<b>2</b>
<b>3. The Unilateral (EU) Dimension</b>	<b>5</b>
3.1 EU Trade Defense Instruments Against Unfair Market Conditions at Home and Abroad	5
3.1.1 Antidumping Measures	5
3.1.2 Countervailing Measures	7
3.1.3 EU Enforcement Regulation and the New Trade Enforcement Officer	8
3.2 Export Controls for Critical Products During Crises	10
3.3 International Procurement Instrument (IPI)	11
3.4 Protection Against Extraterritorial Sanctions	12
3.5 Investment Screening	13
3.6 Carbon Border Adjustment	15
<b>4. The Bilateral Dimension: EU Bilateral and Regional Free Trade Agreements</b>	<b>16</b>
4.1 Ambitious FTAs with Strategic Partners	16
4.2 Ratification of FTAs	18
4.3 Utilization of FTAs	19
<b>5. The Multilateral Dimension: Global Trade Rules Under the WTO</b>	<b>20</b>
5.1 Binding Dispute Settlement System	20
5.2 Binding New Rules for Subsidies	21
5.3 Trade Liberalization and the Status of Developing Countries	22
5.4 WTO Notification and Monitoring	23
<b>6. Conclusion</b>	<b>24</b>

---

## 1. INTRODUCTION

In June 2020, the European Commission launched a review of its trade policy as announced in the proposal for a major recovery plan “Europe’s Moment: Repair and Prepare for the Next Generation.”<sup>1</sup> In a public consultation, the Commission is asking the European Parliament (EP), EU member states, and all other relevant stakeholders, such as civil society and businesses, to provide input for the reform process. The aim is to strengthen EU trade and investment policy in order to help economic recovery after the coronavirus pandemic and to better protect European companies from unfair trading practices from major trading partners.<sup>2</sup>

The reason for the trade policy review lies in the changing geo-economic and geopolitical environment as well as the coronavirus pandemic. Competition on international markets is becoming fiercer. Economic nationalism, protectionism, and unilateralism are on the rise. New tariffs, regulatory barriers, state subsidies, forced technology transfer, and investment restrictions are increasingly putting fair competition to the test.<sup>3</sup> While trade growth rates were already low before the pandemic, trade numbers have plunged since its outbreak. Several countries have implemented new export controls. In addition, global value chains are changing; the trend toward the re-regionalization and re-nationalization of value chains has accelerated. There is a stronger involvement of the state in the economy, and trade policy is increasingly used to achieve geopolitical objectives.

In the United States, President Donald Trump put an end to decades of liberal trade policy, pursuing a protectionist “America First” approach. Washington is increasingly willing to use its economic weight as leverage to pursue American interests. Its weapons of choice are tariffs, new export controls, Buy American rules, investment screening, and sanctions with extraterritorial character. These instruments are not only directed at economic rivals such as China but also at long-standing allies such as Canada and the

EU. Consequently, the EU can no longer rely on its role as a traditional partner of the United States.

China, with its planned economy, restricted market access, and difficult investment environment, has been a political and economic challenge for the EU for years, but competition is getting even fiercer. With its Made in China 2025 Strategy, Beijing is actively promoting key business sectors to become a technological superpower – at the expense of others. China is also willing to use its economic leverage to pursue its geopolitical interests. In March 2019, the EU issued a communication vis-à-vis Beijing, calling the country “an economic competitor in the pursuit of technological leadership and a systemic rival.”<sup>4</sup>

At the same time, the World Trade Organization (WTO) is in deep crisis. Over decades, the WTO, together with its predecessor the General Agreement on Tariffs and Trade (GATT), was the guardian of an open, rules-based trading system. The rules of the multilateral organization, however, no longer reflect the realities of 21st-century trade. The WTO offers little regarding investment, competition, and digital trade. Its rules are weak on subsidies, forced technology transfer, and export controls. In December 2019, the WTO’s dispute settlement mechanism ceased to function due to the refusal of the United States to allow the appointment of new members to the Appellate Body (AB).

The coronavirus crisis poses another severe challenge for the EU. Due to the asymmetrical course of the crisis and recoveries, global trade and global investment flows are likely to recuperate only slowly. According to the WTO, the volume of world merchandise trade is forecasted to drop by 9.2 percent in 2020, followed by a slow recovery of +7.2 percent in 2021.<sup>5</sup>

This has a massive impact on the European Union, which is deeply integrated in the world economy. Total goods exports of the EU-28 accounted for 30.7 percent of world exports (including intra-EU trade) in 2019. Total EU-28 goods imports made up 28.7 percent of world imports (including intra-EU trade).<sup>6</sup>

1 European Commission, EU Long-term Budget 2021–2027: \*Commission Proposal May 2020, May 28, 2020: <[https://ec.europa.eu/info/strategy/eu-budget/eu-long-term-budget/2021-2027\\_en#documents](https://ec.europa.eu/info/strategy/eu-budget/eu-long-term-budget/2021-2027_en#documents)> (accessed August 17, 2020).

2 European Commission, “European Commission Kicks Off Major EU Trade Policy Review,” Press Release, June 16, 2020: <[https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1058](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1058)> (accessed September 27, 2020).

3 WTO, “Trade-restrictive Measures Continue at Historically High Level,” July 22, 2019: <[https://www.wto.org/english/tratop\\_e/tptr\\_e/trade\\_monitoring\\_e.htm](https://www.wto.org/english/tratop_e/tptr_e/trade_monitoring_e.htm)> (accessed August 17, 2020).

4 European Commission, “EU-China: A Strategic Outlook, European Commission Contribution to the European Council,” March 12, 2019, p. 4: <<https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf>> (accessed March 31, 2020).

5 WTO, “Trade Falls Steeply in First Half of 2020,” June 22, 2020: <[https://www.wto.org/english/news\\_e/pres20\\_e/pr862\\_e.htm](https://www.wto.org/english/news_e/pres20_e/pr862_e.htm)> (accessed July 14, 2020).

6 WTO Data: <<https://data.wto.org/>> (accessed October 26, 2020)



Trade as a percentage of GDP stood at 91 percent in 2019;<sup>7</sup> EU exports secure 36 million jobs in Europe.<sup>8</sup>

Reacting to this changed trade policy environment, the new President of the European Commission, Ursula von der Leyen, has proposed a new paradigm for the EU.<sup>9</sup> The new policy approach is to reap the benefits of openness for European businesses, workers, and consumers while protecting them from unfair practices and building resilience to better equip them for future challenges.<sup>10</sup> In addition, trade is to make a greater contribution to climate protection and sustainability.

How can the EU position itself more strategically? Which strategic instruments should the EU have and/or which instruments should be expanded? In the following we will review the core trade policy instruments of the EU in order to make a contribution to the debate on the reform of EU trade and investment policy. While trade and competition policy are closely related, the reform of competition law will be subject to future analysis.

Our analysis focuses on the three – and inseparable – dimensions of EU trade and investment policy: the unilateral (EU), the bilateral, and the multilateral (WTO). We will start with an analysis of the EU's existing and proposed (unilateral) trade defense instruments: antidumping and anti-subsidy measures, as well as the tabled amendments to the Enforcement Regulation and the Chief Trade Enforcement Officer. We will then take a closer look at export controls for medical products before evaluating the proposed International Procurement Instrument and EU rules for investment screening. The second part of the paper is devoted to an analysis of the EU's bilateral free trade agreements (FTAs). We close with an analysis of the multilateral agenda of the EU. In order to level the playing field while simultaneously reforming the rules-based global trading architecture, the recommendations that we propose for each dimension also need to be seen in the context of the other two.

## 2. OPEN STRATEGIC AUTONOMY: THE EU'S NEW TRADE POLICY

The European Commission is working on a new trade strategy. Its most recent one, "Trade for All. Towards a More Responsible Trade and Investment Policy," dates from 2015.<sup>11</sup> While the public consultation has just been extended until mid-November 2020,<sup>12</sup> some priorities can already be derived from von der Leyen's work program, which she presented in a public letter on September 10, 2019, to then Trade Commissioner Phil Hogan. While she emphasized the importance of the WTO, Europe is to retaliate more quickly if others take illegal actions against the European Union and prevent the WTO from settling disputes. In order to achieve this, a Chief Trade Enforcement Officer is to be appointed, whose main task will be to monitor and enforce the implementation of trade agreements.

Furthermore, von der Leyen wants to strengthen Europe's leadership role by renewing the partnership with the United States, signing a comprehensive investment agreement with China, enhancing the economic partnership with Africa, and concluding new ambitious free trade agreements, for example with Australia and New Zealand. Thirdly, the EU's trade policy is to make an active contribution to sustainable development and climate protection. This is not just a matter of the sustainability chapters in FTAs and helping to ensure that the United Nation's Sustainable Development Goals (SDGs) are achieved. Von der Leyen also envisions the introduction of Carbon Border Adjustments to protect domestic producers from unfair competition posed by imports that have a higher carbon footprint.<sup>13</sup>

According to the Commission, the aforementioned trade policy review therefore has two goals. "First, to assess how trade policy can contribute to a swift and sustainable socio-economic recovery, reinforcing competitiveness [...]" Second, the review is to analyze how trade policy can advance a model of Open Strategic Autonomy. The concept note defines Open

7 World Bank, "Trade as Percentage of GDP": <<https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS>> (accessed July 14, 2020).

8 European Commission, *Studie: Internationaler Handel sichert über 36 Millionen Arbeitsplätze in der EU* [Study: International Trade Secures over 36 million Jobs in the EU], November 27, 2018: <[https://ec.europa.eu/germany/news/20181127-handel-36-millionen-jobs-der-eu\\_de](https://ec.europa.eu/germany/news/20181127-handel-36-millionen-jobs-der-eu_de)> (accessed July 14, 2020).

9 Ursula von der Leyen, Speech by President-elect von der Leyen in the European Parliament Plenary on the Occasion of the Presentation of her College of Commissioners and their Programme, November 27, 2019:

<[https://ec.europa.eu/commission/presscorner/detail/en/SPEECH\\_19\\_6408](https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_19_6408)> (accessed August 17, 2020).

10 European Commission, "A Renewed Trade Policy for a Stronger Europe," Consultation Note, June 16, 2020: <[https://trade.ec.europa.eu/doclib/docs/2020/june/tradoc\\_158779.pdf](https://trade.ec.europa.eu/doclib/docs/2020/june/tradoc_158779.pdf)> (accessed August 17, 2020).

11 European Commission, *Trade for All, Towards More Responsible Trade and Investment Policy (2015)*: <[https://trade.ec.europa.eu/doclib/docs/2015/october/tradoc\\_153846.pdf](https://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf)> (accessed August 17, 2020).

12 European Commission, "A Renewed Trade Policy" (see note 9).

13 Ursula von der Leyen, Mission Letter Phil Hogan, Commissioner-designate for Trade, September 10, 2019, pp. 2–6: <[https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-phil-hogan-2019\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-phil-hogan-2019_en.pdf)> (accessed August 17, 2020).



Strategic Autonomy as follows: “This simply means strengthening the EU’s capacity to pursue its own interests independently and assertively, while continuing to work with partners around the world to deliver global solutions to global challenges.” It does not mean that the EU strives for self-sufficiency according to this paper. But it does mean that “trade policy should aim to stabilize our strategic engagement with key trading partners in accordance with our values, interests, and objectives, while helping to diversify our relationships and create alliances with like-minded countries.”<sup>14</sup> While the transatlantic relationship is identified as of great importance, the Commission cautions that close attention has to be paid to developing partnerships with other key trading countries, singling out China as a partner but also a systemic rival.

As a result of the coronavirus crisis, the Commission places particular emphasis on supply chain resilience. While acknowledging that the EU cannot become self-sufficient in critical health products, the Commission wants to improve resilience by proposing a combination of measures. It also implemented highly controversial export controls for protective equipment in the early stages of the crisis.

In mid-June 2020, the Commission also presented a White Paper called “Levelling the Playing Field as Regards Foreign Subsidies” and launched a public consultation on this proposal. This paper focuses mostly on distortions in the EU’s internal market caused by foreign subsidies. While the single market and its rule book ensure a level playing field for all member states, EU rules are rather weak regarding subsidies of foreign economic operators in the EU. The White Paper therefore contains proposals for the strengthening of existing instruments as well as regulatory requirements for the EU Financial Regulation and EU international treaties that aim to prevent direct or indirect distortions of competition in the internal market caused by direct or indirect subsidies from third countries. The instruments affect a wide range of legal areas, including antitrust law, merger control, state aid law, public procurement rules, and investment screening. The White Paper also relates to trade policy aspects in WTO agreements. Trade policy regulations in bilateral agreements concerning the prohibition of subsidies or regulations comparable to EU subsidy law are also affected.<sup>15</sup>

The various concept papers, White Papers, and consultations signal a change in EU trade policy. Von der Leyen and her new Trade Commissioner Valdis Dombrovskis seem to be much more willing to use the economic power of the common market as leverage. Given the changing nature of the trade policy environment worldwide, the European Commission rightly initiated a review of the EU’s trade policy instruments. The EU needs to be better equipped to counter unfair trade practices that harm EU producers at home and abroad. Without doubt, some of the existing instruments require sharpening and new instruments have to be created. While the Commission does not tire of emphasizing the “open” in its new trade policy paradigm – placing much stake in the WTO – the concept of Open Strategic Autonomy also poses some danger. Protectionist sentiments have been on the rise in the European Union for years. They are further buoyed by the coronavirus crisis. Therefore, it is not surprising that most of the debates around Open Strategic Autonomy focus on the defensive side of trade policy. The review could thus tilt trade policy in the wrong direction.

## RECOMMENDATIONS

The European Union has greatly benefitted from globalization and open markets for both trade and investment. Self-sufficiency is therefore not a viable option for the European Union and its member states. Protectionism would cost jobs, income, and wealth, and lead to greater income inequality. A concept such as full reciprocity as applied by the Trump administration – in which openness is compared country by country, sector by sector, and product by product – is not advisable. As history shows, unilateralism, threats of protectionism, and dealmaking have seldomly led to more market access abroad.

Given that a large part of global economic growth will take place outside of Europe in the future, the EU needs to remain open and must continue to play an active role in shaping globalization. In order to be able to effectively assert its values and interests internationally, it must present a unified, consistent, and convincing image to the outside world.

It would be shortsighted for the EU to focus only on the defensive side of trade policy. The reform of its trade policy instruments needs to be carefully calibrated,

<sup>14</sup> Ursula von der Leyen, Mission Letter Phil Hogan (see note 12).

<sup>15</sup> European Commission, White Paper on Levelling the Playing Field as Regards Foreign Subsidies, COM(2020) 253 final, June 17, 2020: <[https://ec.europa.eu/competition/international/overview/foreign\\_subsidies\\_white\\_paper.pdf](https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf)> (accessed August 17, 2020).

and no new doors for protectionism should be opened. Sovereignty should be fostered without encouraging autarky and protectionism. The EU should pursue an active, liberal trade policy. Trade policy should not be used primarily as a lever for other policy objectives. Therefore, the EU needs to push ahead with bilateral and plurilateral trade agreements to open foreign markets and to bind trading partners to rules that ensure fair competition. The EU should also intensify its efforts – together with like-minded countries – to modernize the rule book of the WTO, to strengthen its monitoring instruments, and to reform its dispute settlement mechanism. In doing so, the EU needs to be careful not to further undermine the multilateral trading system by establishing unilateral instruments that are not compatible with WTO rules.

In its efforts to reform its trade policy, the EU needs to consult with all relevant stakeholders and give them enough time to comment on its proposals. It also needs to take possible reactions by third countries into account. Dialogue remains key in preventing a tit-for-tat protectionist spiral.

### 3. THE UNILATERAL (EU) DIMENSION

#### 3.1 EU Trade Defense Instruments Against Unfair Market Conditions at Home and Abroad

In order to level the playing field and counter unfair trade practices, the EU has a variety of trade defense instruments in place.<sup>16</sup> But are these sufficient? The EU regularly publishes reports on the effectiveness of its trade defense instruments. According to the latest report, the antidumping or anti-subsidy duties imposed by the Commission lead, on average, to an 80 percent decrease in unfair imports. In 2019, the Commission used trade defense instruments more actively than in 2018: It launched 16 investigations (2018: 10) and imposed 12 new measures (2018: 6). At the end of 2019, 140 trade defence measures were in force, 94 antidumping, 15 countervailing, and three safeguards. China leads the list of countries most often targeted by antidumping and anti-subsidy measures with 93, followed by Russia (10), India (7), and the United States (6).<sup>17</sup> Nonetheless, there is scope for further reform.

##### 3.1.1 Antidumping Measures

WTO members have committed to not raising tariffs once they have been reduced and bound in their tariff schedules. This ensures legal certainty in international trade. But the WTO's rule book also permits exceptions.

Article VI of the GATT and the Agreement on Implementation of Article VI allow WTO members to impose a tariff – an antidumping tariff or an anti-subsidy tariff (also known as a countervailing duty) – on dumped and subsidized products in order to establish fair conditions of competition. The prerequisite is that the measures are in line with WTO rules.

There are various methods to determine dumping. The one most commonly applied is a comparison between the price charged in the domestic market (normal value) and the price charged in the importing country. If the domestic price cannot be determined, prices of a similar product in a third country can be applied to determine the so-called dumping margin. In the production factor method, the individual cost components incurred in producing a good are calculated and combined.

<sup>16</sup> Mikko Huotari and Agatha Kratz, *Beyond Investment Screening. Expanding Europe's Toolbox to Address Economic Risks from Chinese State Capitalism*, Bertelsmann Stiftung (2019): < [https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/DA\\_Studie\\_ExpandEurope\\_2019.pdf](https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/DA_Studie_ExpandEurope_2019.pdf) > (accessed September 28, 2020).

<sup>17</sup> European Commission, 38th Annual Report from the Commission to the Council and the European Parliament on the EU's Anti-dumping, Anti-subsidy, and Safeguard Activities and the Use of Trade Defence Instruments by Third Countries Targeting the EU in 2019, COM(2020) 164 final, April 30, 2020: < [https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc\\_158733.PDF](https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158733.PDF) > (accessed August 17, 2020).

The determination of dumping alone is not sufficient to justify the imposition of a duty. Rather, it must have caused or threatened to cause serious harm to competing manufacturers in the importing country. WTO rules allow the affected country to impose a tariff on the product in question in order to restore fair competition. This antidumping duty may not be higher than the dumping margin.

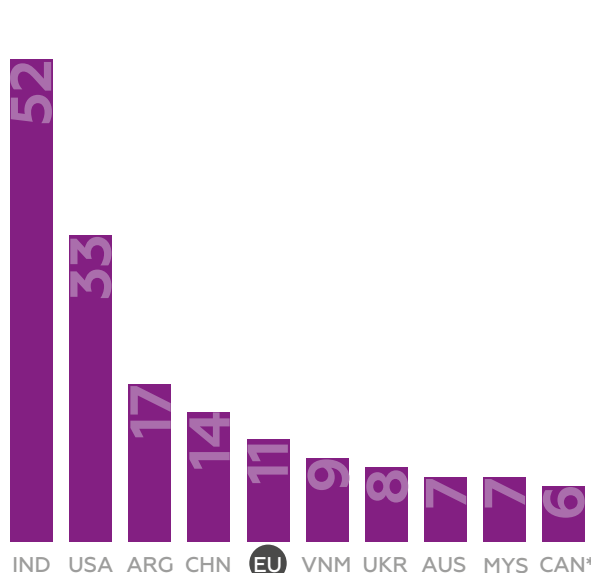
The EU's Antidumping Regulation (AD Regulation), which came into force in 1995, has been repeatedly amended. In the mid-2000s, Peter Mandelson, then Trade Commissioner, attempted a comprehensive reform that aimed to limit the scope of its application. This failed, however, due to considerable resistance from industrial interests in a number of member states.<sup>18</sup>

The European Commission again pushed for a modernization of the trade defense instruments in 2013. The reason for this was that a key article in China's WTO accession protocol was to expire in mid-De-

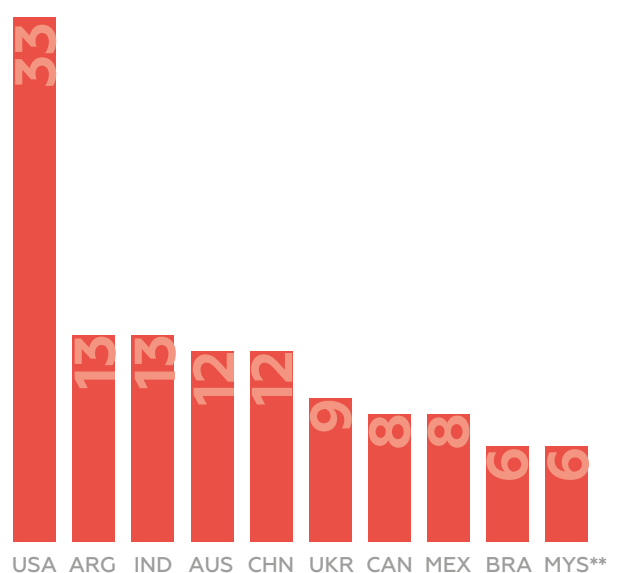
cember 2016. According to this article, Chinese producers had to prove that the prices of their products had been established under conditions of fair competition. Without this proof, dumping could be established on the basis of the analogue country methodology. In 2016, the AD Regulation with its numerous amendments was consolidated in a vertical codification process. Still, it took until July 2018 for an agreement to be reached and for the EU institutions to finally conclude the modernization of the AD instrument.

An important innovation is that the EU no longer makes a distinction between a market economy and a non-market economy, also ending the related normal price calculation based on the analogue country methodology in the case of China. The new method is thus no longer China-specific. Rather, the production factor methodology is now applied to all WTO members in cases of suspected dumping. For non-WTO members, however, the analogue country methodology was retained.

### TOP-10 WTO MEMBERS STARTING ANTIDUMPING INITIATIONS IN 2019



### TOP-10 WTO MEMBERS IMPLEMENTING ANTIDUMPING MEASURES IN 2019



\* In addition to Canada, Egypt, Indonesia, Mexico, and Pakistan also started six antidumping initiations.

\*\* The EU implemented four anti-dumping measures in 2019.

Source: WTO, Antidumping: <[https://www.wto.org/english/tratop\\_e/adp\\_e/adp\\_e.htm](https://www.wto.org/english/tratop_e/adp_e/adp_e.htm)> (accessed October 10, 2020)

<sup>18</sup> Jürgen Matthes, "Handelspolitische Schutzinstrumente zum Umgang mit Wettbewerbsverzerrungen durch China" [Trade Defense Instruments to Deal with Distortions of Competition from China], German Economic Institute (IW), IW-Report 12/19, April 9, 2019: <<https://www.iwkoeln.de/studien/iw-reports/beitrag/juergen-matthes-handelspolitische-schutzinstrumente-zum-umgang-mit-wettbewerbsverzerrungen-durch-china.html>> (accessed August 17, 2020).

In addition, in order to establish the normal price, the costs incurred by EU producers in complying with local environmental and labor standards are now taken into consideration. Furthermore, the application of the Lesser Duty Rule has been modified. There is often a difference between the antidumping margin and the actual damage caused – the injury. In the past, the EU generally used the actual injury to determine the antidumping duty, if the latter was lower than the antidumping margin. Now, the full extent of the dumping margin is taken into account for goods imported by the European Union whose production was made possible by artificially low prices for raw materials or energy. The European Commission is also subject to a reporting obligation, according to which it must make public its own assessments of market distortions in order to help companies to prove distortions of competition. Regarding countries such as China, where there is little transparency about prices and market forces, companies find it more than difficult to present the necessary evidence for dumping.<sup>19</sup>

In December 2016, China lodged a complaint against the EU at the WTO under the provisions of the AD Regulation concerning the determination of normal value for non-market economy countries in antidumping proceedings. A panel was convened in July 2017. After the panel report was finalized, China requested the suspension of the proceeding in May 2019, which was granted in June 2019. On June 15, 2020, the panel's powers under WTO rules expired. The dispute is therefore deemed to be terminated as the panel was not requested to resume its work. This development provides some legal certainty for the EU that the new Antidumping Regulation is WTO compatible.<sup>20</sup>

## RECOMMENDATIONS

EU antidumping measures are essential to protect European producers from unfair competition from abroad. At the same time, it must be ensured that their application complies with the rules of the WTO. The successful completion of the reform of the Antidumping Regulation in 2018 was of great importance to ensure that the instrument was both effective and WTO compatible.

At times, the reversal of the burden of proof posed a major financial and administrative challenge for companies. With the publication of the Commission reports on China, these problems were eliminated. It is now important that the European Commission publishes further market distortion reports.

According to individual business sectors, existing antidumping duties are at times circumvented by various measures.<sup>21</sup> This undermines the effect of the duties and prevents the reestablishment of a level playing field. It is therefore necessary to limit the possibilities of circumvention.

The shortening of antidumping procedures is a positive step forward. It would be particularly in the interests of smaller businesses to further streamline and facilitate the processes. So far, small and medium-sized enterprises (SMEs) have often been reluctant to request antidumping measures because of the financial and administrative challenges associated with them. Administrative costs could also be reduced by further standardizing the individual stages in the procedure, e.g. in the preparation of an AD claim by providing checklists, questionnaires, and decision guidance with explanations on the websites of the Directorate-General for Trade of the European Commission (DG Trade) or the member states.

Furthermore, the EU should more often pursue antidumping and anti-subsidy proceedings in parallel. As providing evidence regarding subsidization remains difficult, a key objective should be to create more transparency on subsidies in third countries.

Overall, there seems to be limited reason for a complete overhaul of the antidumping instrument of the EU. Before any further reforms are implemented, a thorough analysis of the tool and its application is necessary, involving hearings of stakeholders. Any change in the AD Regulation should not be at the cost of one of the parties involved (applicant/defendant); it is important to regard the Union interest.

<sup>19</sup> Elvire Fabry, "Industrial Subsidies are at the Heart of the Trade War," *Notre Europe*, Blog Post, January 1, 2020: <<https://institutdelors.eu/en/publications/les-subsidations-au-coeur-de-la-guerre-commerciale/>> (accessed August 17, 2020).

<sup>20</sup> WTO, DS516: European Union – Measures Related to Price Comparison Methodologies: <[https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds516\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds516_e.htm)> (accessed June 23, 2020).

<sup>21</sup> Stormy-Annika Mildner et al., "Antidumpingmaßnahmen der Europäischen Union" [Antidumping Measures of the European Union], BDI, June 2020: <<https://bdi.eu/publikation/news/antidumpingmassnahmen-der-europaischen-union/>> (accessed August 17, 2020).

### 3.1.2 Countervailing Measures

Industrial subsidies are nothing new but have become an increasing threat to fair competition on global markets in recent years. According to the WTO, new countervailing investigations to address these subsidies among member states have also increased with 55 new investigations initiated in 2018 and 36 in 2019 compared to just nine in 2010.<sup>22</sup>

State-owned enterprises (SOEs) constitute another severe challenge for rules-based and open trade, in particular when SOEs themselves grant subsidies that distort markets and entail unfair competition. In China, for instance, the state retains a majority share in all but one of the 100 largest publicly listed companies.<sup>23</sup> In Russia, SOEs accounted for over 80 percent of the market value, sales, and assets of the ten most prominent firms in 2013.<sup>24</sup>

Especially in China, SOEs function as policy instruments, through which the Chinese government provides loans and raw materials to foster the development of key industries. China has built up overcapacity in various areas and is using it to penetrate markets of third countries through subsidies and price dumping, thus distorting competition.

Countervailing duties (CVMs) are an important tool to counteract subsidies provided by governments or public bodies. The prerequisite is that such a subsidy is granted to a specific firm, industry, or group of firms or industries. While export subsidies and subsidies based on using domestic goods over imported ones are specific, there are considerable limitations in the definition of subsidies in the international rule book and that of the EU. For example, it is controversial whether an SOE is a “public body” subject to the WTO anti-subsidy regime. Furthermore, transparency about subsidization in third countries is very weak; hardly any comparative data is available. In addition, the procedure to obtain the authorization for countervailing duties is quite difficult. The complainant carries the burden of proof to show that injury has been suffered, which discourages complaints from being lodged. Last but not least, EU countervailing duties are only applied to trade in goods, not trade in services.

## RECOMMENDATIONS

The WTO rules on subsidies are comparatively weak. Therefore, a first reform step must include a reform of the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement). This will be dealt with in chapter five of this study. The WTO reform is indispensable for a far-reaching reform of the EU instruments, as the EU must make sure that any changes are WTO compatible.

Because a reform of the SCM Agreement of the WTO could take years, the EU should use all available policy space to make its countervailing instrument more effective. In the future, CVMs should be designed in such a way to more fully address the market-distortive effects of foreign SOEs and industrial subsidies. This can help ensure competitive neutrality.

While, traditionally, CVMs have not been applied as often as AD duties and business has less experience with them, the EU should launch an official consultation process. Furthermore, as transparency and data are key, the EU – together with the other members of the OECD – should mandate the OECD to collect, analyze, and make public data on subsidization and SOEs.

A comprehensive reform of the SCM Agreement and the EU's CVM Regulation would, however, only tackle the trade side of the issue. The EU's White Paper “Levelling the Playing Field as Regards Foreign Subsidies” is therefore a step in the right direction. The problem of state induced market distortions in domestic competition, competition in third markets, investment (including mergers and acquisitions (M&A)), and public procurement also need to be addressed.

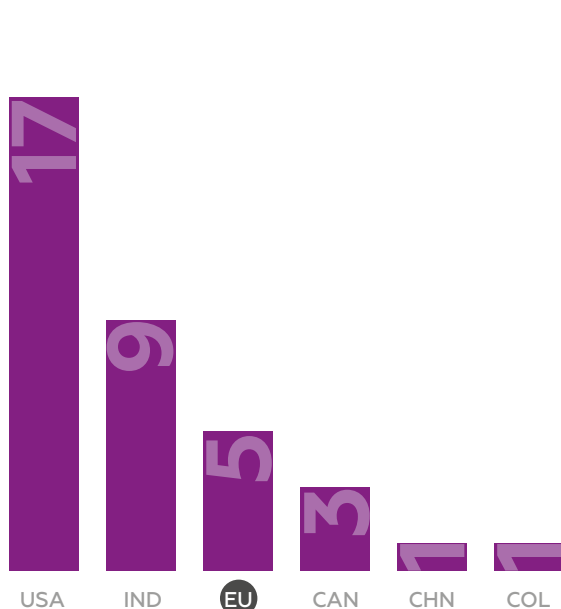
<sup>22</sup> WTO, “Countervailing Initiations: by Exporter 01/01/1995–31/12/2019”: <[https://www.wto.org/english/tratop\\_e/scm\\_e/CV\\_InitiationsByExpCty.pdf](https://www.wto.org/english/tratop_e/scm_e/CV_InitiationsByExpCty.pdf)> (accessed August 18, 2020).

<sup>23</sup> WTO, Trade Policy Review of China, WT/TPR/S/375, June 6, 2018: <[https://www.wto.org/english/tratop\\_e/tpr\\_e/s375\\_e.pdf](https://www.wto.org/english/tratop_e/tpr_e/s375_e.pdf)> (accessed March 6, 2020).

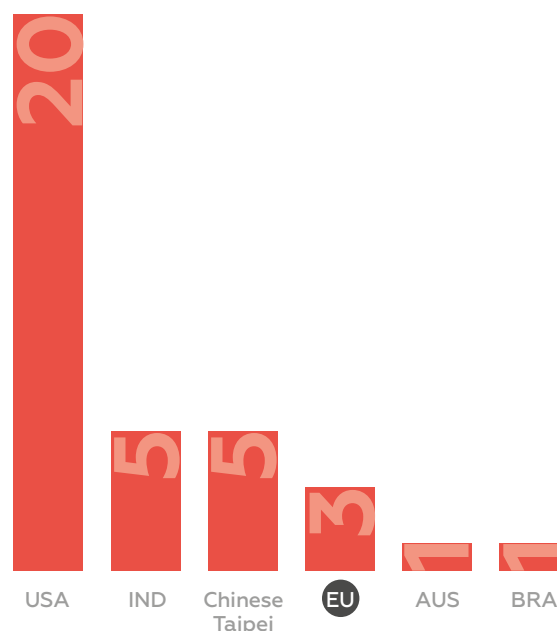
<sup>24</sup> WTO, Trade Policy Review of the Russian Federation, WT/TPR/S/345, August 24, 2016: <[https://www.wto.org/english/tratop\\_e/tpr\\_e/s345\\_e.pdf](https://www.wto.org/english/tratop_e/tpr_e/s345_e.pdf)> (accessed March 26, 2020).



### ALL WTO MEMBERS STARTING COUNTERVAILING INITIATIONS IN 2019



### ALL WTO MEMBERS IMPLEMENTING COUNTERVAILING MEASURES IN 2019



Source: WTO, Subsidies and Countervailing Measures: [https://www.wto.org/english/tratop\\_e/scm\\_e/scm\\_e.html](https://www.wto.org/english/tratop_e/scm_e/scm_e.html) (accessed October 10, 2020)

#### 3.1.3 EU Enforcement Regulation and the New Trade Enforcement Officer

In December 2019, the European Commission proposed an amendment to the present EU Enforcement Regulation (EU) No. 654/2014, which deals with the EU's right of enforcement of international trade rules. The new proposal came two days after the Appellate Body of the WTO ceased to function.

The Commission views the amendment as a top priority to ensure that the European Union can enforce international trade law. Under current rules, the EU is only able to adopt countermeasures at the end of a WTO dispute settlement procedure with a final panel or Appellate Body ruling. The EU thus depends on authorization by the WTO to impose retaliatory measures, which is no longer possible without a functioning Appellate Body. Under the proposed amendment, the EU would be allowed to impose countermeasures against third countries when the EU has received a favorable panel report but where the appeal is going nowhere because of the Appellate

Body blockage. If the concerned party does not agree to an interim appeal arbitration under Art. 25 WTO DSU, the EU would be allowed to impose countermeasures without a final WTO ruling.<sup>25</sup>

Such measures include customs duties, quantitative restrictions, and measures in the area of public procurement. They are to be “selected and designed on the basis of objective criteria, including the effectiveness of the measures in inducing compliance of third countries with international trade rules, their potential to provide relief to economic operators within the Union affected by the third countries’ measures, and aim at minimizing negative economic impacts on the Union, including with regard to essential raw materials.”<sup>26</sup>

These amendments are clearly directed at countries like the United States, which has blocked the reform of the WTO dispute settlement system. Subsequent to the breakdown of the WTO's Appellate Body, the EU – together with 22 other members of the WTO – established a multi-party interim appeal arbitration

<sup>25</sup> European Commission, “Commission Proposes New Tools to Enforce Europe's Rights in International Trade,” Press Release, December 12, 2019: [https://ec.europa.eu/commission/presscorner/detail/en/QANDA\\_19\\_6757](https://ec.europa.eu/commission/presscorner/detail/en/QANDA_19_6757) (accessed March 31, 2020).

<sup>26</sup> European Commission, Proposal for a Regulation of the European Parliament and the Council Amending Regulation (EU) No 654/2014 of the European Parliament and of the Council Concerning the Exercise of the Union's Rights for the Application and Enforcement of International Trade Rules, COM(2019) 623 final 2019, 0273 (COD), December 12, 2019: [https://www.europarl.europa.eu/RegData/docs\\_autres\\_institutions/commission\\_europeenne/com/2019/0623/COM\\_COM\(2019\)0623\\_EN.pdf](https://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/com/2019/0623/COM_COM(2019)0623_EN.pdf) (accessed August 17, 2020).

arrangement (MPIA) in March 2020. Any participating countries can use this arrangement to settle disputes among themselves until the Appellate Body is back to normal. While China has joined the MPIA, the United States is not a party to the mechanism.<sup>27</sup>

On April 8, 2020, the Council approved its negotiating position. It basically follows the proposal by the European Commission but wants to shorten the review process to three years. The EP Committee on International Trade (INTA) adopted its negotiating position on July 6, 2020. INTA wants to broaden the scope of possible countermeasures to services and intellectual property rights (IPR). It also proposes to enable the EU to take provisional measures before a final WTO ruling. In addition, INTA wants to give the EP and Council the right to initiate the enforcement procedure, which so far fell in the competencies of the Commission. Finally, INTA wants to have an earlier review process. The next step in the legislative process is now the trialogue negotiations of the Commission, Council, and EP.<sup>28</sup>

Von der Leyen and Dombrovskis proposed yet another – so far little specified – enforcement instrument: the anti-coercion mechanism to protect the EU from the coercive activities of trade partners such as the United States and China. For example, this instrument could be used to counter extraterritorial sanctions. Little is known about the ideas of the Commission so far, but the debate has already reached the capitals of large EU member states such as France and Germany. Various proposals are being circulated, including the idea to counter extraterritorial sanctions with market access restrictions in the EU for services or government procurement or with temporary suspensions of certain property right protections.

In addition, the EU has created a new post: the Chief Trade Enforcement Officer (CTEO) at the level of Deputy Director-General within DG Trade. The Enforcement Officer is responsible for monitoring and improving compliance with EU trade agreements by partner countries. This includes monitoring trade partners' commitments under sustainable development chapters in EU trade agreements. However, there is still quite a bit of uncertainty regarding the concrete mandate and resources of the CTEO. In late July 2020, the European Commission appointed Denis Redonnet to the function of Deputy Direc-

tor-General in DG Trade, which encompasses the new role of CTEO.

## RECOMMENDATIONS

The amendments to the Enforcement Regulation as proposed by the Commission are an important step to deal with trade conflicts. If a country is not willing to engage in mediation after a WTO panel report, the EU needs the reformed Enforcement Regulation to ensure a fair outcome and reciprocity in its trade relations. The proposal of the EP, on the other hand, goes too far in some respects. Granting the Parliament and the Council the right to initiate the enforcement process risks a politicization of the instrument. Particularly dangerous is the idea to implement measures before a final panel report. This would severely undermine the rule of law and, as such, the credibility of the EU as a defender of the rules-based trading system. It also risks retaliatory measures by the targeted country.

Regardless of the reform of the Enforcement Regulation, the first priority must always be the reform of the multilateral dispute settlement system. The new interim appeal arbitration must not be a gateway for protectionism.

The coercive defense mechanism raises many technical, legal, and strategic questions. An act of economic coercion must be clearly defined and its costs to the Union must be precisely calculated. If this is possible remains to be seen. Furthermore, such a mechanism should not breach European or international law, including the WTO's rules, but also those embedded in the EU's bilateral trade agreements. In addition, as is the case with all defensive instruments, market access restrictions also always hurt the EU itself. Thus, the Union interest always needs to be regarded. Last but not least, the EU needs to consider that such an instrument is likely to entail countermeasures by third countries. These possible costs also need to be included in the Commission's cost-benefit analysis.

The CTEO should be given a clear and transparent mandate on the basis of which he can act. The effectiveness of the post also depends on the resources devoted to the CTEO's office. The CTEO should be required to regularly publish reports on his activities and their effectiveness.

<sup>27</sup> European Commission, "EU and 15 World Trade Organization Members Establish Contingency Appeal Arrangement for Trade Disputes," Press Release, March 27, 2020: <<https://trade.ec.europa.eu/doclib/press/index.cfm?id=2127>> (accessed March 31, 2020).

<sup>28</sup> European Parliament, Review of EU Enforcement Regulation for Trade Disputes, July 20, 2020: <[https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/652021/EPRS\\_BRI\(2020\)652021\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/652021/EPRS_BRI(2020)652021_EN.pdf)> (accessed August 11, 2020).



### 3.2 Export Controls for Critical Products During Crises

In the course of the coronavirus crisis, concerns have arisen regarding the supply of medical and personal protective equipment (PPE). With its Implementing Regulation 2020/402, the EU made the export of PPE subject to authorization until the end of April 2020.<sup>29</sup> This meant that exports from the EU were prohibited unless a license was obtained. The granting of such licenses was limited to exceptional circumstances that required extensive checks. Shortly thereafter, the EU revised its regulation (Implementing Regulation 2020/426) and issued guidelines that effectively lifted the restrictions for the European Free Trade Association (EFTA). The restrictions on exports to other third countries, however, remained in place. With Regulation EU 2020/568, the EU continued to control the export of protective spectacles and visors, mouth-nose-protection equipment, and protective garments. Furthermore, the Commission announced it would monitor national licensing authorities.<sup>30</sup> The export controls finally expired on May 26, 2020.

The EU's export controls were likely to be WTO compatible given the weakness of the organization's rules on export restrictions. In Article XI, paragraph 1, WTO members have committed to not introduce any quantitative restrictions on exports or export bans. Paragraph 2, however, contains a comprehensive exception: "Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party" are permitted.<sup>31</sup> WTO members are neither obliged to notify the measures to the WTO, nor to prove that a supply shortage actually exists. If members move to restrict exports of foodstuffs temporarily, the Agreement on Agriculture requires them to give due consideration to the food security needs of others.

Nonetheless, export restrictions pose a considerable danger. The EU's export restrictions led to delays along the value chains because PPE is an indispensable production factor in many industrial processes, such as cleanroom production. This is especially true for the production of drugs and medical equipment.

Important production sites of the (European) chemical and pharmaceutical industry are located outside Europe – in particular in the United States, China, Brazil, Indonesia, South Africa, Canada, Mexico, and Russia. If international production networks are interrupted, the EU also feels the supply shortages.

## RECOMMENDATIONS

Export controls – even if they are compatible with WTO rules – are not the right way to address alleged shortages in critical products with complex value chains. Instead of protectionism, a policy is needed that secures and strengthens global supply chains for protective gear and medical goods. To increase resilience, the EU should analyze vulnerabilities in critical supply chains. Further measures include the diversification of supply at country and company levels as well as strategic reserves and stockpiling.

In the medium to long term, the EU should work on WTO reform regarding export restrictions because export tariffs and quantitative restrictions have repeatedly caused problems for EU businesses.

In addition, the EU should push the G20 countries to eliminate customs duties on pharmaceutical products and intermediate products as well as medical products in an unbureaucratic, comprehensive, and lasting manner. A pragmatic approach should be taken that avoids costly customs procedures as well as excessively narrow product coverage, which could lead to unjustified disadvantages and distortions in the supply chains. The tariff reductions should be bound under the WTO and applied on a multilateral basis.

<sup>29</sup> Federal Office for Economic Affairs and Export Control, "Export von Medizinischer Schutzausrüstung" [Export of Medical Protective Equipment], March 23, 2020: <[https://www.bafa.de/SharedDocs/Kurzmeldungen/DE/Aussenwirtschaft/Ausfuhrkontrolle/20200323\\_export\\_medizinische\\_schutzausruestung.html](https://www.bafa.de/SharedDocs/Kurzmeldungen/DE/Aussenwirtschaft/Ausfuhrkontrolle/20200323_export_medizinische_schutzausruestung.html)> (accessed April 1, 2020).

<sup>30</sup> European Commission, Durchführungsverordnung (EU) 2020/568 der Kommission vom 23. April 2020 über die Einführung der Verpflichtung zur Vorlage einer Ausfuhrgenehmigung bei der Ausfuhr bestimmter Produkte [Commission Regulation (EU) 2020/568 of April 23, 2020, introducing an Obligation to Present an Export Licence when Exporting Certain Products], April 23, 2020: <<https://eur-lex.europa.eu/legal-content/DE/TXT/HTML/?uri=CELEX:32020R0568&from=DE>> (accessed April 29, 2020).

<sup>31</sup> WTO, Article XI GATT, General Elimination of Quantitative Restrictions: <[https://www.wto.org/english/res\\_e/publications\\_e/ai17\\_e/gatt1994\\_art11\\_gatt47.pdf](https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art11_gatt47.pdf)> (accessed August 10, 2020).

### 3.3 International Procurement Instrument (IPI)

Public procurement is a major part of the European economy. More than 250,000 public authorities in the EU spend around 14 percent of GDP on public purchases, which accounts for about two trillion euros per year.<sup>32</sup> The purchases relate to goods and services in areas such as public health, transportation, education, public infrastructure, security, etc. These public expenditures will further increase in the course of the current coronavirus crisis.

According to the Commission, European companies are among the most affected worldwide by discriminatory measures in public procurement. These measures include so called *de jure* barriers such as “buy national” provisions and the exclusion of certain projects from government procurement rules. They also include *de facto* barriers such as a lack of transparency, unpredictable enforcement of regulation, and corruption.<sup>33</sup>

The EU has opened its public procurement markets for certain goods and services in the framework of the Agreement on Government Procurement (GPA) of the WTO. The United States is also part of the agreement; China is negotiating an accession. While the European market is comparatively open, many other procurement markets are still closed. According to the Commission, the EU opened public procurement worth 352 billion euros to member countries of the GPA in 2012, whereas the United States offered public procurement worth 178 billion euros and Japan only 27 billion euros. China has only opened up a very small fraction of its market.<sup>34</sup> There is also an increasing danger that subsidized companies, in particular Chinese SOEs, create unfair competition in the EU's internal market as competition for contracts is becoming more fierce.

In order to level the playing field, the European Commission proposed a new procurement instrument in 2012 called the International Procurement Instrument (IPI). Following a legislative deadlock, the Commission amended the proposal in January 2016. In the changing geo-economic and geopolitical environment, many of the large member states, such as Germany and France, now have a more positive view

on the proposal than in the past. Therefore, the ratification of the new instrument seems within reach.

The new procedure consists of three steps. First, the Commission starts a public investigation if there is a possible discrimination of European companies in the public procurement market of a third country. Second, the Commission will start discussions with the respective country about a possible opening of the procurement market if the public investigation finds discriminatory practices. Third, the Commission can – but only as a means of last resort – introduce a price penalty of up to 20 percent of the value of the offer. The prerequisite is that the offer has a total value of at least 5 million euros, of which at least 50 percent consist of goods and services originating from the respective country.<sup>35</sup> There are exceptions for least developed countries (LDCs) and small and medium-sized enterprises (SMEs). The IPI is to be applied to so-called non-covered goods and services, i.e. not to goods and services that originate in a country with which the EU has concluded an international agreement in the field of public procurement.

## RECOMMENDATIONS

The IPI would help the EU to achieve more reciprocity in government procurement. It would strengthen the principle of balanced mutual market access, which is anchored in the GPA. The Commission's current IPI proposal, however, also requires further revision in order to avoid negative effects on the procurement process.

Thus, excessive bureaucratic costs and legal uncertainty for EU companies and contracting authorities, as well as risks in view of the proposed system of penalties, must be avoided. The IPI needs to be balanced, non-protectionist, and compatible with the rules and principles of the GPA. The aim must always be to open the respective third country's procurement system. Restrictions on the EU market as a last resort should, where appropriate, be as targeted and effective as possible. Closing off the EU market – for example, to a reciprocal level with third countries – should not be the aim of the IPI.

<sup>32</sup> European Commission, Public Procurement: <[https://ec.europa.eu/growth/single-market/public-procurement\\_en](https://ec.europa.eu/growth/single-market/public-procurement_en)> (accessed March 31, 2020).

<sup>33</sup> BusinessEurope, “BusinessEurope's Views on an International Procurement Instrument,” Position Paper, May 20, 2020: <[https://www.besbusiness.eu/sites/buseur/files/media/position\\_papers/rex/2020-05-20\\_views\\_on\\_an\\_international\\_procurement\\_instrument.pdf](https://www.besbusiness.eu/sites/buseur/files/media/position_papers/rex/2020-05-20_views_on_an_international_procurement_instrument.pdf)> (accessed August 17, 2020).

<sup>34</sup> European Parliament, “A Balanced and Progressive Trade Policy to Harness Globalization, A New EU International Procurement Instrument (IPI),” Legislative Train Schedule, June 24, 2020: <[https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-international-procurement-instrument-\(ipi\)>](https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-international-procurement-instrument-(ipi)>) (accessed August 17, 2020).

<sup>35</sup> Ibid.

Furthermore, the leverage effect vis-à-vis third countries should be increased, for example by more effective price penalties. The planned price premium of up to 20 percent for bidders from sanctioned states might be insufficient. There are cases in which the offer from Chinese state-owned companies was around 25 percent lower than the next best offer. Since such companies do not act solely on market-based conditions, it should be possible to completely exclude bidders.

Penalties are triggered if more than 50 percent of the total value of the goods in the tender originates from the targeted third country. Given the complexity of global value chains, establishing origin can be very complex and lengthy. This provision could also harm European companies, which are deeply integrated in global markets. The EU should thus discuss shifting the focus from the origin of the goods to the bidding entity.

In addition, the investigation and consultation timeline should be considerably shortened. According to the current proposal, they could take up to 27 months in total – a period that does not reflect the reality of procurement timelines.

The IPI will be applied only to covered goods and services under the GPA. Still, there is also ample discrimination of European companies by countries that are part of the GPA. Therefore, the EU needs to intensify its efforts to have the relevant provisions of international agreements on public procurement be strictly applied.

At the same time, the EU needs to ensure that the IPI does not negatively impact relations with partner countries. Thus, dialogue and consultations remain key. The EU should also double its efforts to encourage more countries to join the GPA and strengthen its chapters in bilateral and plurilateral trade agreements.

Last but not least, comparative data on government procurement is very weak internationally. The EU and its member states should not only lead by example by publishing more in-depth data on government procurement, but they should also strongly advocate for international organizations such as the WTO and the OECD to be mandated to compile comparative data.

### 3.4 Protection Against Extraterritorial Sanctions

The United States has been using extraterritorial sanctions for decades to coerce other countries – including long-standing allies such as the EU – to adhere to US strategic policy goals. Already in 1996, the US adopted extraterritorial measures concerning Cuba, Iran, and Libya. Its Helms-Burton Act, for example, denies visas to persons who do business in Cuba on properties that were expropriated from US citizens. The Iran and Libya Sanctions Act of 1996 – and the subsequent Iran Sanctions Act of 2006 – also imposed economic sanctions on companies that do business with the respective countries.

The EU does not accept the extraterritorial application of laws by third countries and sees this as a breach of international law. It therefore adopted the so-called blocking statute in 1996 (Council Regulation (EC) No 2271/96) with the aim of protecting EU citizens and business against this kind of legislation. The statute invalidates the effect of any foreign court ruling based on these laws in the EU and allows EU citizens to recover court damages. It also prohibits EU economic operators from complying with any requirement or prohibition based on the specified foreign laws. Businesses are to inform the Commission if their interests were negatively impacted by the extraterritorial application of foreign laws. In special circumstances, the Commission can grant companies an exception from complying with the blocking statute.<sup>36</sup>

After the United States pulled out of the Iran nuclear deal (officially, the Joint Comprehensive Plan of Action), Washington started reimplementing sanctions in August 2018. The EU immediately updated the blocking statute to include the coverage of these sanctions. In addition – with the support of the EU, Germany, France, and the UK – it initiated a new instrument of settlement for commercial accounts between EU member states and Iran: the special purpose entity Instrument in Support of Trade Exchanges (INSTEX).

The EU blocking statute and INSTEX are not, however, enough to outweigh the dramatic economic consequences of the US sanctions, in particular in light of US sanctions against Russia. The EU fears that eventually the United States could also implement sanctions against China, which would hit EU companies hard.

<sup>36</sup> European Commission, Blocking Statute:

<[https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/blocking-statute\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/blocking-statute_en)> (accessed August 17, 2020).

## RECOMMENDATIONS

Extraterritorial sanctions harm the economic and foreign policy sovereignty of the EU and impair the global competitiveness of the European economy. Therefore, the EU needs to sharpen its tools to counter extraterritorial sanctions.

The use of the EU's blocking statute is an important political signal. Its effectiveness, however, is questionable. Furthermore, there is a fundamental flaw in the approach as it punishes domestic businesses in order to induce a policy change in the United States. The EU should therefore examine the effects more closely in order not to harm European companies and make its findings public.

INSTEX is a step in the right direction, but it does not reach far enough. The EU should intensify its efforts to ensure better access to essential export-related services, in particular for the processing of payments. If such regulatory measures for payment transactions are too risky for private payment service providers, a state alternative for payment transactions must be created. To ensure its effectiveness, the mechanism should encompass a critical mass of EU member states.

At the center of the EU's ability to counter extraterritorial sanctions stands the role of the EU in the international payment system. To strengthen its use and make the European Union less dependent on the US dollar, the EU needs to advance its financial sector reforms; push further integration – at least in the Euro Area; and strengthen its attractiveness by increasing investment in the competitiveness of its economy.

### 3.5 Investment Screening

Worries about a sell-out of European key industries are nothing new, but they have increased during the coronavirus crisis. Takeovers – in particular, those from China – have attracted public attention in recent years although their annual number has declined since 2016. The acquisition of the German robot manufacturer KUKA, the Chinese purchase of shares from Daimler, and the investment in the German network operator 50Hertz were particularly controversial.

In response, the German government tightened investment screening in 2017 and 2018. A reporting requirement was introduced for takeovers of critical infrastructure companies. The list of economic sectors in which acquisitions require governmental approval has also been extended to include various “key technologies.” The extension of inspection periods has given the government further leeway. The threshold above which investments from third countries can be prohibited was lowered from 25 percent to 10 percent for critical infrastructures.

In spring 2019, a European foreign investment screening regulation came into force (EU 2019/452). While neither a European nor a common national FDI screening procedure is yet in place, the EU created a framework for investment screening and laid the foundation for a systematic exchange of information between member states and the Commission. Member states keep the last word on whether to allow a specific investment in their territory. If an investment poses a threat to the public order and security in more than one member state, the Commission can issue an opinion. This is also the case when an investment endangers a program that is of interest to the Union.

Consequently, many EU members need to reform their investment laws, including Germany. The reform of the Foreign Trade and Payments Act (AWG), passed in June 2020, foresees that, in the future, investment prohibitions will be justified not only by the security interest of the Federal Republic of Germany but also by the public order and security interest of another EU member state. The “security of projects or programs of Union interest” poses another ground. In the fields of defense equipment and IT security products, it is now not only companies that manufacture or develop the corresponding products that can be examined but also those that use or modify such products or those that have used such products in the past. In the old AWG, the pre-

condition for government intervention was the existence of an “actual and sufficient serious danger” to the basic interests of society. According to the new law, “likely impairment” suffices as a justification. The wording is based on the EU Screening Regulation.

Germany also amended its Foreign Trade and Payment Ordinance (AWV). The amendments took effect on June 3, 2020. According to this 15th amendment, new sectors are brought under the regulation of critical infrastructure, including the health sector (PPE, essential drugs, in vitro diagnostics in the field of infectious diseases, and medical devices for infectious diseases). Furthermore, the regulation specifies that asset deals are within the scope of the FDI screenings regime. Last but not least, the review can now also consider whether an acquirer is directly or indirectly controlled by a government.<sup>37</sup>

Another reform of the AWV is expected later this year, likely adding further sectors and industries to the catalog of critical infrastructures.

According to the AWG, the government can review and prohibit takeovers of German companies from third countries if there is an actual and sufficiently serious threat to the basic interests of society. A pandemic, such as the current one, is one such reason to consider. Accordingly, the German government should be careful not to add further sectors and industries to the catalog of critical infrastructures that do not face a permanent threat for national security and public order.

On the European level, the inclusion of the security interests of other member states, as well as programs of Union interest, is justifiable. The European member states should, however, take care that the revision does not lead to industrial policy instrumentalization in practice.

## RECOMMENDATIONS

Europe greatly benefits from foreign investment. Without question, governments should intervene to protect national security and public order. But investment screening needs to be proportionate and not create uncertainties and unjustified infringements on private property. Situations in which the state can and should intervene need to be clearly defined. Political measures should not encourage the international trend toward investment protectionism.

In the German AWG, the substitution of “actual and sufficient serious danger” to the basic interests of society with “likely impairment” creates considerable legal uncertainty. It remains largely open in which respect impairments must exist and how serious an impairment must be. This imprecise formulation extends the discretionary scope of the administration – also against the background of the requirements of the EU Screening Regulation – well beyond what is necessary. Therefore, the next reform should aim to specify this indicator.

Germany’s federal government already has a wide range of instruments at its disposal to deal with the current challenges – also during the coronavirus crisis.

<sup>37</sup> Hartmut Krause, “Germany: Update on Foreign Direct Investment Screening – Health Care Sector Becomes Part of Critical Infrastructure,” Allen & Overy, June 3, 2020: <<https://www.allenoverly.com/en-gb/global/news-and-insights/publications/germany-update-on-foreign-direct-investment-screening>> (accessed August 17, 2020).



### 3.6 Carbon Border Adjustment

The European Climate Law that was proposed by the Commission is one of the most important components of the so-called EU Green Deal, including a legally binding target of net zero greenhouse gas emissions by 2050. This goal also has a trade dimension. To ensure that EU industry is not put at a disadvantage vis-à-vis foreign producers, the Commission proposes to install a border adjustment mechanism (BAM) for greenhouse gas-intensive goods from countries that have implemented no or insufficient climate protection measures. Products from these countries could be subject to tariffs, or foreign producers could be obliged to purchase emission rights. The proceeds from these measures could be used to finance investment programs under the Green Deal. In early March 2020, the European Commission initiated an Impact Assessment of BAM. The public consultation period is open until late October 2020.

Two factors speak for government measures to reduce CO<sub>2</sub> emissions. On the one hand, climate is a public good for which the self-regulation of markets fails. Since the use of the Earth's atmosphere has no price in a pure market system, there is little incentive to treat it carefully. On the other hand, CO<sub>2</sub> emissions are external effects emanating from production; they affect the situation of other economic participants but do not appear in the cost balance of the emitter. Through climate protection measures such as limits for CO<sub>2</sub> emissions, CO<sub>2</sub> taxes, or tradable emission certificates, the state can put a price on the climate good and allocate the external costs to the polluter.

If the important economies do not all engage in climate protection, however, an optimal allocation is not possible. The restriction of the use of CO<sub>2</sub>-intensive, carbon-based fuels (coal, oil, and natural gas) results in economic costs for energy-intensive industries in the signatory states. The consequence is a weakening of the international competitiveness of these industries compared to competitors in countries without binding climate protection targets. This, in turn, provides an incentive to relocate energy- and carbon-intensive industries to countries with less ambitious climate targets. Consequently, domestic production would be replaced by imports of carbon-intensive goods. It is quite possible that the production of the imported goods is associated with higher emissions than domestic production – the domestic emission reductions could then be more than offset by increased emissions abroad (carbon leakage).

In this respect, on first sight, it makes perfect sense to flank climate policy instruments with a BAM – not only to ward off competitive disadvantages but also to prevent non-signatory states from undermining multilateral climate protection goals. It is questionable, however, whether such measures are compatible with WTO law, particularly the following three principles:

1. The most-favored nation treatment rule, according to which trade concessions granted to one WTO member must also be granted to all others;
2. National treatment, according to which imported goods should be treated equally to locally-produced goods after they have entered the market;
3. The like-product rule, which prohibits worse treatment of “similar (like) goods.”

The WTO allows BAM for indirect taxes, i.e. taxes on products. If the marginal burden of an imported CO<sub>2</sub>-containing energy source is not excessively high in comparison to the tax burden of a domestic similar product and does not give it a competitive advantage, border adjustment is considered to be WTO compatible. The legality of border adjustment in the case of goods that are greenhouse gas-intensive in their production, however, has not been clarified. The tax would therefore be levied because of the production method. But according to the like-product rule, the consideration of production and process methods is only permissible if they shape certain characteristics of the product.

Article XX GATT provides an exception: trade restrictions are permitted if human, animal, or plant health is endangered. The same applies to the protection of an exhaustible natural resource – even outside the jurisdiction of the state concerned. This was confirmed by the WTO Appellate Body in 1998 in the landmark dispute over US import restrictions on shrimp from Thailand to protect sea turtles endangered by the fishing methods that were used. The prerequisite is that the trade restriction must make a direct contribution to the conservation of this exhaustible natural resource and must neither constitute arbitrary discrimination against states nor create a competitive advantage for the domestic product. Furthermore, no alternative, less trade-distorting instruments can be available.

In the end, whether a BAM is WTO compatible or not can ultimately only be decided by the WTO Dispute

---

Settlement Body. Furthermore, collecting the relevant data to determine the CO<sub>2</sub> content of a product will be very difficult, making the implementation of a BAM very challenging as well.

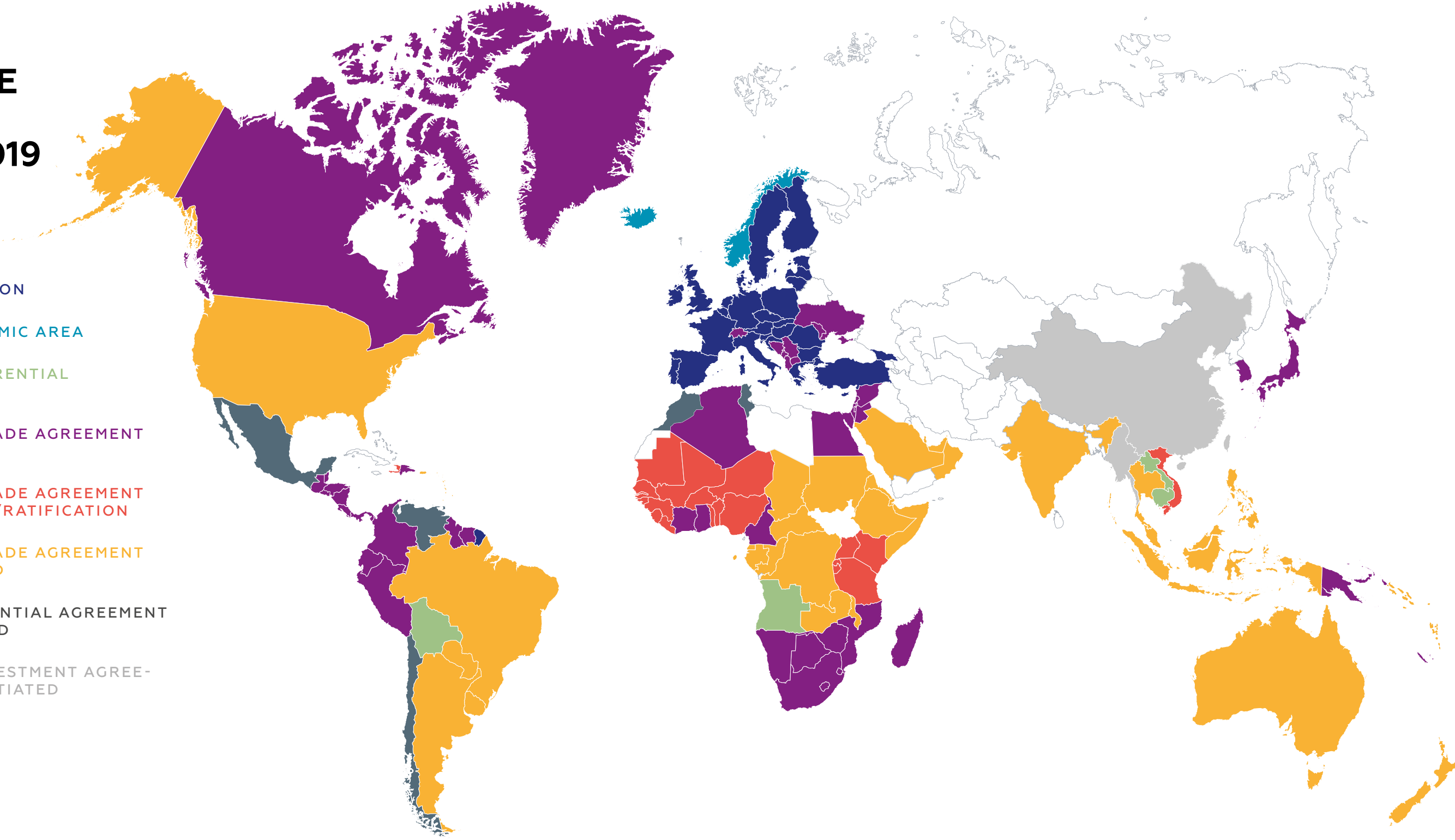
## RECOMMENDATIONS

Carbon Border Adjustments should only be implemented under the strict proviso that WTO compatibility and practicability are guaranteed. A careful and comprehensive impact assessment is indispensable before the Commission takes legislative initiatives. In addition, the Commission should evaluate further instruments against carbon leakage. Furthermore, support for the transformation of industry is key. When assessing alternatives, practical feasibility and possible effects on complex value chains and networks – as well as on the export side of the economy – must be soundly considered. Disproportionate bureaucratic efforts for administration and businesses must be avoided. The risk of carbon leakage should not simply be shifted to other parts of the value chain. Negative effects on downstream industries and disruptions in international value chains must be avoided. Last but not least, it is important to note that a BAM risks retaliatory measures by key trading partners. Therefore, the EU needs to engage in a dialogue on its planned reforms early on, for example in the realm of the G20.



# THE STATE OF EU TRADE 2019

- EU & CUSTOMS UNION
- EUROPEAN ECONOMIC AREA
- POTENTIAL PREFERENTIAL TRADE PARTNERS
- PREFERENTIAL TRADE AGREEMENT IN PLACE
- PREFERENTIAL TRADE AGREEMENT UNDER ADOPTION/RATIFICATION
- PREFERENTIAL TRADE AGREEMENT BEING NEGOTIATED
- EXISTING PREFERENTIAL AGREEMENT BEING MODERNISED
- STAND-ALONE INVESTMENT AGREEMENT BEING NEGOTIATED



Source: European Commission, DG Trade, 2019 Annual Activity Report: <[https://trade.ec.europa.eu/doclib/docs/2020/july/tradoc\\_158886.pdf](https://trade.ec.europa.eu/doclib/docs/2020/july/tradoc_158886.pdf)> (accessed October 10, 2020)

## 4. THE BILATERAL DIMENSION: EU BILATERAL AND REGIONAL FREE TRADE AGREEMENTS

FTAs have been a key feature of the European Union's trade agenda since its Global Europe Strategy of 2007.<sup>38</sup> Therefore, contrary to general opinion, the European Commission has acted strategically in trade policy for more than a decade, looking for partners with large market opening opportunities. The EU's strategy is driven by both interests and values.

After considerable criticism and protest about the way the EU conducted trade policy during the negotiations for the Transatlantic Trade and Investment Partnership (TTIP), the EU updated its trade strategy with the Trade for All communication in 2015.<sup>39</sup> Increasing the transparency of negotiations, the Commission now urges the Council to publish the negotiating mandates immediately after adoption. In addition, the Commission has started to publish the key negotiating texts and the final text of all ongoing FTA negotiations online. In addition, the Commission holds regular stakeholder consultations on various trade policy issues.

### 4.1 Ambitious FTAs with Strategic Partners

Since 2007, the EU has successfully negotiated a wide range of new, ambitious trade agreements, which cover a variety of areas outside traditional market access. Modern trade agreements have been concluded with industrialized countries (Canada, Japan), emerging market economies (Singapore, Brazil/Mercosur), and developing countries (Vietnam, Indonesia). They include chapters on trade in goods and services, technical barriers to trade (TBT), sanitary and phytosanitary measures, customs and trade facilitation, subsidies, investment, digital trade, competition policy, SOEs, government procurement, and the protection of intellectual property rights (IPR). FTAs also include a dispute settlement mechanism. And because these new generations of EU trade agreements substantially cover all trade (Art. XXIV GATT), they are in line with WTO rules. In addition, these agreements contain a number of WTO-Plus provisions, which could be multilateralized at a later date.

Since 2011, the EU has also included chapters on trade and sustainable development (TSD) in its FTAs. These chapters include commitments for both sides to ratify specific International Labor Organization (ILO) conventions and to comply with the standards of multilateral environmental agreements such as the Paris Agreement. If one party breaks the TSD commitments, there will be government-to-government consultations. Unlike in FTAs negotiated by the United States, however, TSD is not subject to the dispute settlement of a bilateral agreement. The Commission believes that sanctions are not the right way to improve the implementation of the TSD chapters.

Currently, the EU has concluded agreements with 31 countries that have entered into force and agreements with 46 countries that have entered into force provisionally. Furthermore, the EU is currently negotiating agreements with an additional 29 countries, although 24 of these are suspended or paused for the time being.<sup>40</sup> Apart from FTAs, these numbers also include Association Agreements (e.g. with Chile, Egypt, and Tunisia), Economic Partnership Agreements (EPAs with African, Caribbean, and Pacific countries), Stabilization and Association Agreements (with West Balkan countries), and Partnership and Cooperation Agreements (e.g. with Iraq, Kazakhstan, and Armenia). Table 1 (see pp. 26–27) provides an overview of the status of the FTAs that have been negotiated since the Global Europe Strategy of 2007.

These comprehensive FTAs with strategic partners have positive economic effects as they increase market access on both sides, fostering trade and investment, which, in turn, boosts economic growth and job creation. This is particularly important in the context of the economic depression resulting from the coronavirus crisis. Furthermore, FTAs help to shape globalization and rules-based trade. They contain modern WTO-plus trade rules, which are needed to address important trade issues for European companies.

In addition, from a geo-economic perspective, FTAs with strategic partners help the EU to uphold rules-based trade with important trading partners in times of WTO crisis. If the WTO system further deteriorates, the current web of ambitious free trade agreements can serve as an insurance system for the EU.

<sup>38</sup> European Commission, "Global Europe, Competing in the World," October 4, 2006: <<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0567:FIN:en:PDF>> (accessed April 10, 2020).

<sup>39</sup> European Commission, *Trade for All* (see note 10).

<sup>40</sup> European Commission, *Negotiations and Agreements*: <[https://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/#\\_in-place](https://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/#_in-place)> (accessed April 7, 2020).

---

## RECOMMENDATIONS

In order to preserve and increase the EU's leverage in these trade agreements, the unity of EU member states is crucial. EU member states must focus their efforts on fostering cohesion around common European positions. This is essential in the current geo-economic environment, in which only EU unity can help the EU to remain an important player in global trade and investment.

Given the upcoming ratification process of the EU-Mercosur trade agreement, the idea of a sanctions-based approach to the TSD chapter will return to the agenda – particularly with regard to the Amazon fires in Brazil. The improvements to the existing model (increased transparency, a more assertive approach) will probably not be enough. A consultation and mediation approach should remain the way forward. Furthermore, the EU could consider side-agreements to the FTA covering environmental issues.

In addition, the EU should consider deepening the agreements even further. One important area would be more ambitious chapters on digital trade, which should cover the gaps that exist in the global trading regime in order to create legal certainty and limit protectionism. Therefore, such chapters should include, for example, provisions on the non-discriminatory treatment of imported digital products. It is also necessary to limit requirements for data localization. In addition, EU FTAs should contain strong rules to combat threats to cybersecurity.

Further areas to strengthen are the chapters on subsidies and SOEs; MSMEs; notification requirements, particularly for non-tariff barriers; and dispute settlement.

TABLE 1 – EU FREE TRADE AGREEMENTS (FTAS) SINCE THE GLOBAL EUROPE STRATEGY 2007

● North America ● Asia ● Oceania ● Latin America

COUNTRY	NAME OF THE FTA	STATE OF THE AGREEMENT	FURTHER INFORMATION
Canada	Comprehensive Economic Trade Agreement (CETA)	On September 21, 2017, CETA provisionally entered into force after ratification by the EP. It now needs to be ratified by the individual EU member states due to its investment chapters.	CETA is the most ambitious FTA of the EU to date and serves as a model for future agreements. In addition to increased market access, it includes, among others, chapters on TBT, sanitary and phytosanitary measures (SPS), customs and trade facilitation, subsidies, investment, services, e-commerce, competition policy, SOEs, government procurement, and IPR protection (including geographic indicators).
United States	Transatlantic Trade and Investment Partnership (TTIP)  Other Agreements	Negotiations on TTIP started in 2013 and ended without conclusion ("put in a freeze") at the end of 2016. The Council decided in April 2019 that the negotiating directives are now obsolete.  There are two new mandates on an agreement for the elimination of tariffs on industrial goods and on conformity assessment.  In August 2020, the EU and the US concluded a small agreement that eliminates EU tariffs on lobster in return for lower US tariffs on some EU goods on a most-favored-nation (MFN) basis.	The next steps for the negotiations on the two possible agreements on industrial goods and conformity assessment need to be decided.  A new approach toward a transatlantic agreement will need to wait until after the US elections in November 2020.
Mexico	(Modernized) EU Mexico Global Agreement	The EU and Mexico wanted to update their existing agreement from 2000. Negotiations started in 2016; two years later, in April 2018, the EU and Mexico were able to reach a political agreement.  In April 2020, both sides reached a final agreement.	The EU Mexico agreement includes chapters on trade in services, IPR, customs, and investment. Both sides also reiterate their obligations under the Paris Agreement. Discussions on a list of entities at the sub-federal level in Mexico, which would open their public procurement markets for EU companies, were solved in April 2020.  Right now, the legal scrubbing of the agreement is taking place. After its translation into all EU languages, the ratification procedure will start.
South Korea	EU-South Korea FTA	The agreement had been provisionally applied since July 2011 and was finally ratified in December 2015.	This was the first FTA that the EU concluded with an Asian country and it was deeper and more ambitious than any agreement the EU had negotiated so far. The agreement addresses non-tariff barriers to trade (NTBs), especially in the important automotive, pharmaceutical, and electronics sectors. It also includes provisions on competition, government procurement, and IPR.
Association of South East Asian Nations (ASEAN)	EU-ASEAN Region to Region Trade and Investment Agreement	In 2007, the EU tried to negotiate an agreement with ASEAN. This attempt was abandoned in 2019 in favor of bilateral agreements with individual ASEAN countries.	The bilateral agreements with individual ASEAN countries are based on the ASEAN negotiation directives.  There is also an EU-ASEAN Joint Working Group, which has discussed the possibility of a future EU-ASEAN agreement since 2017.
Singapore	EU-Singapore FTA  (ASEAN Negotiating Directives)	Negotiations started in 2010. The agreement was signed on October 19, 2018. Because of uncertainties about the EU ratification process, the FTA could only enter into force in November 2019 once it was ratified by the EP and endorsed by the MS.  The investment protection agreement (IPA) still needs to be ratified by the 27 EU member states before it can enter into force.	Singapore is the most developed country in the region and the third largest Asian investor in the EU (after Japan and Hong Kong). The agreement liberalizes trade in services and addresses a variety of behind the border issues such as TBT (mutual recognition), SPS, government procurement, IPR, and subsidies.
Malaysia	EU-Malaysia FTA  (ASEAN Negotiating Directives)	In 2010, the EU also launched FTA negotiations with Malaysia. However, the negotiations were put on hold in 2012 due to differences in the levels of ambition. The new government, which came into office in 2018, still has to announce how it will approach the negotiations.	

Source: Own compilation based on information provided by DG Trade, European Commission

COUNTRY	NAME OF THE FTA	STATE OF THE AGREEMENT	FURTHER INFORMATION
Vietnam	EU-Vietnam FTA (ASEAN Negotiating Directives)	In 2012, the EU launched negotiations with Vietnam. The trade and investment agreements were concluded and signed in June 2019.  The Free Trade Agreement with Vietnam entered into force on August 1, 2020.  The IPA still needs to be ratified by EU member states.	Vietnam is the EU's second largest trading partner in ASEAN. The EU trade agreement with Vietnam is the most ambitious deal ever signed with an emerging economy. The agreement includes chapters on services, government procurement, and regulatory barriers as well as a chapter on social and environmental protection standards.
Thailand	EU Thailand FTA (ASEAN Negotiating Directives)	In 2013, the EU started negotiations with Thailand. However, the negotiations were suspended in 2014 due to the military coup in the country.	In October 2019, the Council stressed that it is important to take steps to resume the negotiations.
Philippines	EU Philippines FTA (ASEAN Negotiating Directives)	Negotiations were launched in December 2015, but, since 2017, no date was set for the next round of negotiations.	In September 2016, the EP expressed concern about the high number of people who were killed in the anti-crime and anti-drug operations of the Philippine government ("War on Drugs"). The EP condemned these actions again in March 2017 and April 2018. As the EU connects free trade agreements with a respect for human rights and democracy, there is currently no progress in the negotiations.
Indonesia	EU Indonesia FTA (ASEAN Negotiating Directives)	In 2016, negotiations were launched. In June 2020, the last round of negotiations took place.	The EU's aim is to cover as wide a range of complex trade issues as contained in the agreements with Singapore and Vietnam. Thus, there will be chapters on trade in goods and services, government procurement, trade remedies, IPR, customs, etc. However, similar to the agreement with Vietnam, the EU will take the development status of Indonesia into account.
India	EU India	The negotiations started in 2007, however, due to the different levels of ambition, they have not proceeded any further since 2013.	India is the tenth largest trading partner of the EU (2019) and belongs to the fastest growing large economies in the world (pre-COVID). Therefore, an agreement would be highly beneficial for both sides.
Japan	Economic Partnership Agreement with Japan (EUJEP)	In March 2013, the EU launched negotiations with Japan. EUJEP entered into force in February 2019.  There are separate negotiations going on about an IPA with Japan.	Japan is the second most important trading partner of the EU in Asia after China. The agreement abolished tariffs on almost all product lines and liberated trade in services. It also includes many ambitious trade chapters on subsidies, SOEs, competition, public procurement, and sustainable development.
Australia	EU-Australia FTA	In June 2018, negotiations started on a FTA with Australia.	Negotiations are proceeding quickly, and the Commission has already issued text proposals for all substantial areas.  In order to have an EU-only agreement, the EU has decided to leave investment out of the negotiations.  The last negotiating round took place in September 2020 via video conference.
New Zealand	EU-New Zealand FTA	In June 2018, negotiations started on a FTA with New Zealand.	Negotiations are proceeding quickly. Investment protection is also left out of this agreement.  The next negotiation round will take place after the general elections in New Zealand in October 2020.
Mercosur	EU-Mercosur Region to Region Agreement	Negotiations were started in 2000. After long periods of no progress, both sides reached a political agreement in June 2019.  Both sides are engaged in the legal revision. After its translation into all EU languages, the ratification process can start.	The ambitious agreement includes chapters on TBT, SPS, services, government procurement, IPR, sustainable development, and SMEs.  Due to the fires in the Amazon region, there is a lot of opposition regarding the ratification of the agreement in the EP and the member states. The governments of Austria, France, and Ireland have stated that they will refuse to ratify the agreement in its present form.

#### 4.2 Ratification of FTAs

The EU has a ratification problem. For a long time, there was considerable legal uncertainty concerning the mixed and exclusive competence of the EU and its member states – in other words, which chapters of an FTA had to be passed by both the EU and national level and which chapters only needed to be agreed upon by the EU level. The May 2017 decision of the European Court of Justice on the EU-Singapore FTA finally brought light into this issue. The court ruled that the investment provisions – on portfolio investments and a dispute-settlement regime for investments – required ratification by the EU level and all member states while the remainder of the issues fell under the exclusive competence of the EU.<sup>41</sup>

Although this clarification is helpful for future trade agreements, it does not solve the ratification problem of older agreements. Currently, association agreements with six countries, EPAs with 30 countries, FTAs with five countries, and partnership agreements with five countries are provisionally applied.<sup>42</sup> In most instances, this means that the parts that fall under EU competence are provisionally applied after ratification by the EP. These provisions relate to the IPA – portfolio investment and investment dispute resolution – which still await ratification by the member states. This is also the case for the agreements with Canada, Singapore, Vietnam, and Japan.

In order to avoid only partially ratified agreements, the EU decided to carve out the IPAs from future trade agreements. Consequently, the EU started to negotiate FTAs with Australia and New Zealand only on issues related to trade and foreign direct investment, which fall under the exclusive competence of the EU.

widely held beliefs, this approach does not undermine the legitimacy of EU trade policymaking. Through the Lisbon Treaty, the European Parliament has a strong say in trade policy. It not only has to be consulted regularly on the agreements, but it also votes on them. The member states, on the other hand, have a strong say in the decisionmaking process through the Council.

The Commission, however, is not the only body that is responsible for creating transparency in trade policymaking; rather, the executive branches of the respective member states also need to keep their legislators informed and consult with them on a regular basis.

The carving out of IPAs is one way to move the bilateral trade agenda forward. The EU should not end its efforts here, however. Investment protection and the resolution of investment disputes remain important. Therefore, the EU should continue its efforts to negotiate modern investment treaties and to gather support for the establishment of a multilateral investment court. Most urgently, negotiations on the bilateral investment treaty between the EU and China, which was supposed to be finalized by the end 2020, need to be pursued more forcefully.

## RECOMMENDATIONS

For the EU to remain an attractive FTA partner to third countries, it needs to ensure that mixed and provisionally applied trade agreements are decided upon by the legislatures of the EU member states in a more timely manner.

The EU's decision to negotiate trade agreements that fall into the exclusive competence of the Union – and thus do not need to be ratified by the legislatures of all member states – is the right way forward. Contrary to

<sup>41</sup> Arthur Beesley, "EU Singapore Ruling Charts Possible Brexit Path," *Financial Times*, May 16, 2017: <<https://www.ft.com/content/f9cf18e4-3a1b-11e7-ac89-b01cc67cfeec>> (accessed April 16, 2020).

<sup>42</sup> BDI, "Aiming for Better Utilization of EU Free Trade Agreements," March 25, 2020, p. 6: <<https://english.bdi.eu/publication/news/aiming-for-better-utilization-of-eu-free-trade-agreements/>> (accessed August 17, 2020).



#### 4.3 Utilization of FTAs

A third problem of existing FTAs – apart from the lack of EU unity and the complexity of ratification – is their low utilization rate by EU companies. In a 2018 study for the European Commission, Lars Nilsson and Nicolas Preillon looked at the preference utilization rate (PUR), which is the share of trade that takes place under the preferential tariffs of FTAs. That study found that the average PUR among 18 FTAs was 77.4 percent and for Germany 78 percent.<sup>43</sup> In a follow-up survey, the Federation of German Industries (BDI) found three major reasons for the lack of FTA use in Germany:

1. Costs and bureaucracy to comply with the agreement, in particular rules of origin (RoO);
2. Lack of internal capacity to verify the complex compliance procedure;
3. Legal uncertainties in verifying whether a product falls under the FTA.

If the tariff margin between the preferential tariffs and the bound WTO tariff is very low and the different EU FTAs vary too much, it is often easier for companies to simply use the WTO tariff.<sup>44</sup>

Rather tellingly, the utilization rates of the Comprehensive Economic and Trade Agreement (known as CETA) and the EU-Japan Economic Partnership Agreement (EUJEPa) are particularly low. According to the Commission, the PUR for CETA in 2018 was only 37 percent. Partly, this is because implementation is ongoing, and companies are still getting familiar with the agreements. However, companies also point to changes in the verification procedures of RoO. The main responsibility for origin verification was transferred from the customs authorities of the exporting countries to the authorities of the importing country. The importer's knowledge is now central to the verification process. According to the Commission, this shift was made to ensure that preferential treatment was properly applied while simplifying both the proof and verification of origin. Companies, however, fear that the new procedures will not only lead to legal uncertainty but also infringe on intellectual property rights and endanger sensitive data (e.g. European know-how, prices, and production processes).

Subsequent legal specifications in the EU-Japan agreement were not able to eliminate these worries.

Another problem that companies have identified is the direct transport principle in many FTAs. In order for a good to qualify for preferential tariff treatment, it must be shipped directly from one partner country of the agreement to the other. Consequently, companies that use central storage facilities (hubs) for long delivery routes often do not benefit from preferential tariffs.

## RECOMMENDATIONS

In order to improve the utilization rate of FTAs, the EU should negotiate simple and standardized rules of origin that apply to all sectors (and possibly to all agreements) to avoid a spaghetti bowl of rules. Doing so would make it easier for companies to adhere to these rules. To facilitate the use of FTAs by SMEs, it would also be advisable to have IT systems in place that can test whether an export product falls under the preferential tariffs in a standardized way.

Another means of helping companies would be to introduce a more flexible cumulation rule to all FTAs. Cumulation reflects the regionalization and globalization of value chains, allowing producers greater flexibility regarding sourcing inputs and parts. Cumulation allows originating products of country A to be further processed or added to products originating in country B, just as if they had originated in country B. There are three forms of cumulation: bilateral, diagonal, and full cumulation, the latter being the most flexible – and far-reaching – type. Full cumulation already applies in CETA, EUJEPa, and the European Economic Area, and it should be applied in all future FTAs.

The problems associated with the direct transport principle and the use of regional hubs could be solved by innovative technologies such as microchips placed directly on the goods.

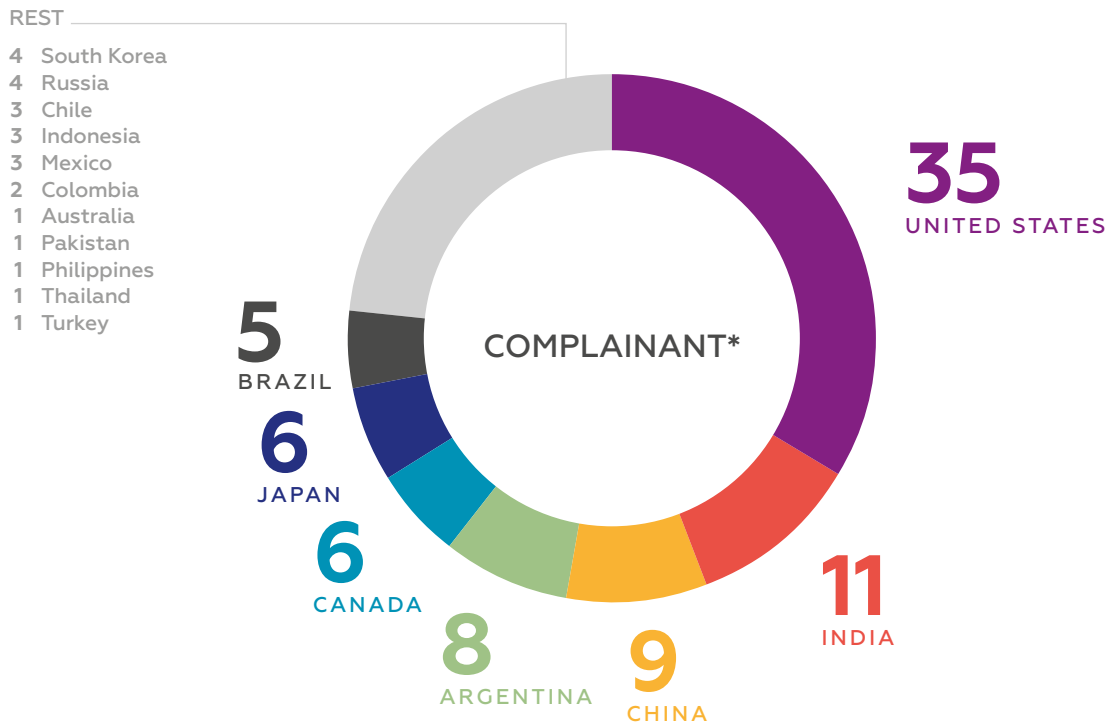
In addition, the EU needs to ensure that the verification procedure for rules of origin does not risk disclosing sensitive data to foreign authorities. Furthermore, it is important to increase information about the requirements and benefits of FTAs, foremost making them more attractive for SMEs.

<sup>43</sup> Lars Nilsson and Nicolas Preillon, "EU Exports, Preference Utilisation and Duty Savings by Member State, Sector, and Partner Country," DG Trade Chief Economist Note (June 2018): <[http://trade.ec.europa.eu/doclib/docs/2018/june/tradoc\\_156931.pdf](http://trade.ec.europa.eu/doclib/docs/2018/june/tradoc_156931.pdf)> (accessed April 7, 2020).

<sup>44</sup> BDI, "Aiming for better Utilization" (see note 41), pp. 14–15.



## DISPUTES BETWEEN WTO MEMBERS – EU AS A ...



\* Since the founding of the WTO in 1995 | Source: WTO

At the same time, the EU needs to increase its efforts to ensure that FTA partners play by the rules of the game. In the past, there have repeatedly been problems in the area of non-tariff barriers and notification requirements. The new Chief Trade Enforcement Officer could play an important role in this regard.

## 5. THE MULTILATERAL DIMENSION: GLOBAL TRADE RULES UNDER THE WTO

The EU is the largest trading bloc in the world and has highly integrated trade relationships with many countries and regions. As such, it is dependent on the transparent and binding rules-based trading system of the WTO. The EU is therefore highly committed to the reform of the organization.

The WTO has four main pillars, all of which are in crisis:

1. The dispute settlement system;
2. The rule-setting function;

3. Multilateral trade liberalization, namely the Doha Development Round (DDA);
4. Trade policy monitoring to which the notification of subsidies is connected.

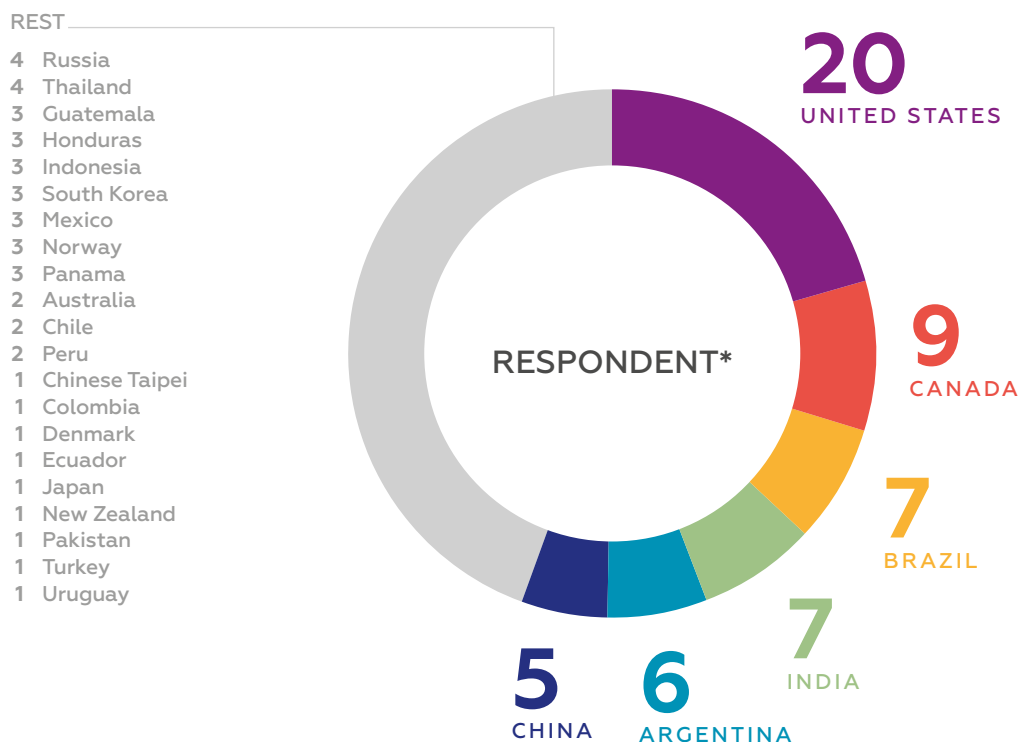
In its concept paper of September 2018, the EU tried to shape the discussions on WTO reform in a constructive way, offering concrete proposals.

### 5.1 Binding Dispute Settlement System

The EU is an active user of the WTO dispute settlement system. Since the creation of the WTO, the EU has been a complainant in 104 cases including, among others, 35 against the United States, eleven against India, and nine against China. The cases against the United States mainly dealt with safeguard measures, such as US antidumping and countervailing duties, as well as large civil aircraft (Boeing). The complaints against China focused on antidumping duties and measures related to the export of various raw materials (raw earths).<sup>45</sup>

The EU has also been sued (a respondent) in 87 cases since 1995. The United States brought 20 cases

<sup>45</sup> WTO, "Dispute Settlement: Disputes by Complainant": [https://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_by\\_country\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm) (accessed May 3, 2020).



\* Since the founding of the WTO in 1995 | Source: WTO

against the EU, and China five. The main complaints from the US involved safeguard measures, IPR enforcement, large civil aircraft (Airbus), and sanitary and phytosanitary issues such as hormone beef or genetically modified organisms (GMOs). The Chinese complaints mainly involved antidumping measures on products such as steel and footwear as well as price comparison measures. In addition, the EU has been a third party in 208 cases.<sup>46</sup>

The administration of US President Donald Trump was the first to shine a spotlight on the functioning of the WTO dispute settlement system – foremost on the procedure and rulings of the Appellate Body (AB). The concerns of the United States relate to disregard for the 90-day deadline for appeals, continued service by persons who are no longer AB members, the issue of advisory opinions, and the claim that AB reports are entitled to be treated as precedents. In addition, the US criticizes that the AB has added to or diminished the rights and obligations of the member states. This criticism relates specifically to the defi-

nition of what constitutes a “public body,” which is essential for the use of trade remedies.

In response to this criticism, the EU published a “concept paper” on WTO modernization in September 2018,<sup>47</sup> which lists all of the ongoing – and sometimes very technical – details of the US concerns about the AB and tries to provide very specific answers to them (see Table 2 on p. 32). So far, the initiative has already been officially sponsored by eleven other WTO member states, including China, Canada, India, Australia, South Korea, and Mexico.

The United States objected to the reform proposals – foremost the provision to expand the term for AB members. The underlying US concerns are less technical and more political. The current US administration does not want an international body to interfere with its American trade and trade remedy laws. In the end, Washington opposes any international body that supposedly hampers its ability to fight dumping and hidden subsidies of non-market economies such as China. Consequently, the conflict remains unsolved.

<sup>46</sup> WTO, “Dispute Settlement: Disputes by Member”: <[https://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_by\\_country\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm)> (accessed May 3, 2020).

<sup>47</sup> European Commission, “WTO Modernization: Introduction to Future EU Proposals,” Concept Paper, September 18, 2018: <[https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc\\_157331.pdf](https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf)> (accessed May 4, 2020).

**TABLE 2 – MAIN US CONCERNS REGARDING THE APPELLATE BODY AND EU RESPONSES**

US CONCERNS	EU RESPONSES
90-day deadline for appeals (Art. 17.5) has repeatedly been ignored	<p>The EU suggested amending Article 17.5 of the dispute settlement understanding (DSU) to state that: "In no case shall the proceedings exceed 90 days, unless the parties agree otherwise." If there is no agreement, there should be a mechanism that ensures that the working arrangement could be adapted to stay within the deadline.</p> <p>In addition, the EU proposes to increase the number of AB members from seven to nine and provide that the membership is a full-time job to increase the efficiency of the Appellate Body.</p>
Continued service by persons who are no longer AB members (Rule 15)	The EU also proposes the introduction of transitional rules to avoid that members continue to serve on the Appellate Body even though their terms expired. According to the EU proposal, Rule 15 should be codified. Then, the DSU could agree e.g. that an outgoing Appellate Body member could complete the pending appeal.
Issuing of advisory opinions on issues that are not necessary for the solution of the dispute	The EU proposes to modify Article 17.12 of the DSU to avoid the issuing of advisory opinions that are not relevant to the case. The article now states that the Appellate Body "shall address each of the issues raised" on the appeal. Here, the EU proposes to add: "to the extent this is necessary for the resolution of the dispute."
AB reports are entitled to be treated as precedents (judicial overreach)	Finally, the EU wants to introduce regular exchanges between the AB and WTO members to address the issue of legislative overreach. Here, concerns about the approaches of the Appellate Body rulings could be voiced. In addition, the EU proposed to have a single but longer term for Appellate Body members (from six to eight years) to increase the independence of the appeals body.

Source: Own compilation based on information in the EU Concept Paper "WTO Modernization" (see note 46)

The ongoing refusal by the United States to appoint new judges to the AB has led to a crisis of the dispute settlement system. On December 10, 2019, there were less than three members left, which is the minimum required for an appeal. Without a functioning AB, any party to a dispute may attempt to block the adoption of panel rulings by appealing them. As a result, the whole WTO dispute settlement process is essentially inoperative.

In order to restore a functioning rules-based dispute settlement, the EU initiated the establishment of the multi-party interim appeal arbitration arrangement (MPIA) together with 22 other WTO member states. This arrangement will help settle disputes until the AB is back to normal. If Joe Biden, the Democratic candidate, wins the US presidential elections in November 2020, progress could be possible. Although the Democrats share almost all of the aforementioned concerns voiced by the Trump administration, they are more willing to work together with partners like the EU to achieve reforms.

## RECOMMENDATIONS

The decision of the EU to create a MPIA is an important intermediary step in upholding the rules-based multilateral trading system. The MPIA must not, however, prevent the EU (and other countries) from trying to reform the binding Appellate Body and make it work again. The EU's proposals are well considered and provide a good basis upon which to develop future WTO reform. The EU should therefore continue to try to gather support from the other WTO member states for its reform proposals.

Regardless of who becomes the next US president, the EU should pursue all available means to establish a dialogue in order to convince the US administration of the need for a reformed but binding Appellate Body. This can be done through government-to-government consultations as well as through a variety of channels such as the Transatlantic Economic Council, Transatlantic Business Dialogue, and Transatlantic Legislators Dialogue.

## 5.2 Binding New Rules for Subsidies

While the WTO rule book contains disciplines on subsidies, these are weak – in particular regarding SOEs. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) only vaguely defines subsidies. It also only covers export subsidies and subsidies intended to increase domestic supply or replace imports. The SCM Agreement defines a subsidy as (a) a financial contribution (b) by the government or any public body within the territorial jurisdiction of a member state, which (c) confers a benefit. Furthermore, only specific subsidies are subject to the disciplines of the SCM Agreement (see Table 3 on p. 34).

In addition to the very narrow scope of prohibited subsidies and the limited definition of actionable subsidies under the SCM Agreement, recent findings of the WTO's AB further limit the reach of this agreement. In its March 2011 ruling on Chinese SOEs and the use of antidumping and countervailing measures,

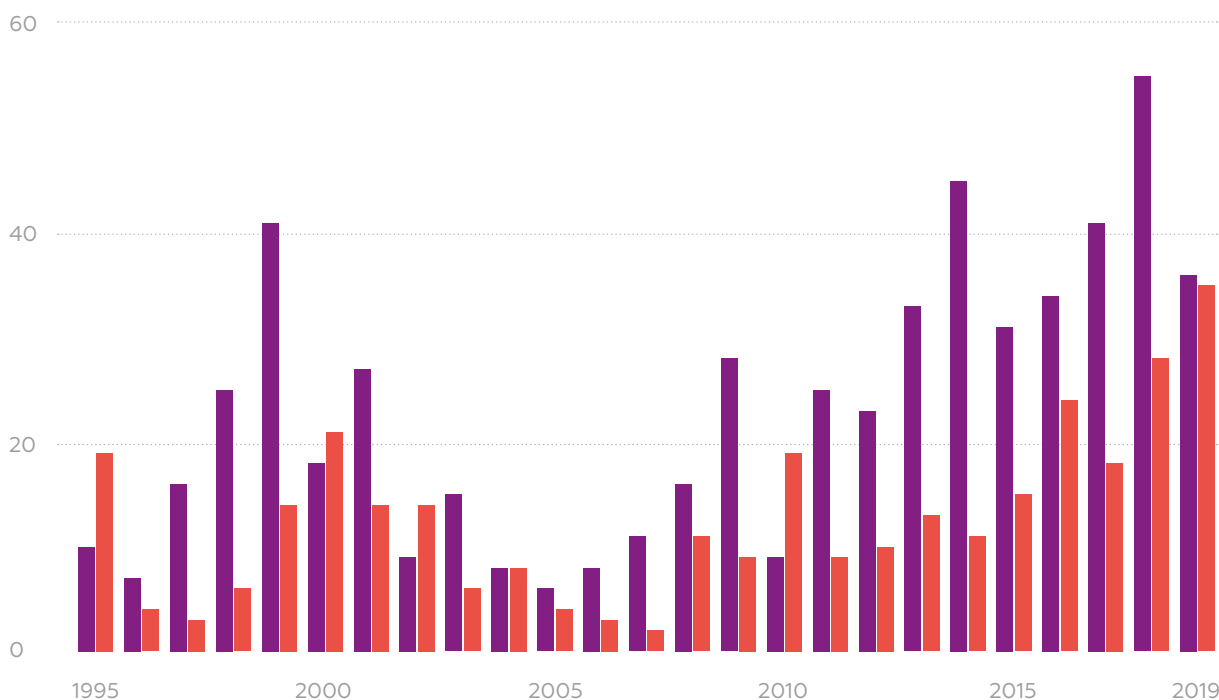
the AB issued a very narrow definition of what constitutes a “public body.” The ruling states that a public body needs to “possess, exercise, or be vested with governmental authority.” This does not cover SOEs.

Moreover, the hurdles to obtain the authorization for countervailing duties are high: The complainant bears the burden of proof to show the injury that has been suffered and must demonstrate a causal link between the injury and the subsidized imports. Opaque government funding in some countries makes this very difficult. In addition, the notification disciplines under the WTO for subsidies are weak.

On January 14, 2020, in the context of the Trilateral Initiative, the EU, the United States, and Japan issued a joint statement. Among other proposals, this statement tables a comprehensive reform of the SCM Agreement to more precisely regulate government subsidization of industrial goods and their exports.

## COUNTERVAILING INVESTIGATIONS AND MEASURES INITIATED AMONG WTO MEMBERS, 1995–2019

New Investigations   Measures Imposed



Source: WTO, “Countervailing Initiations: by Exporter 01/01/1995–31/12/2019” (see note 21) and “Countervailing Measures: By Reporting Member 01/01/1995–31/12/2019”: [https://www.wto.org/english/tratop\\_e/scm\\_e/CV\\_MeasuresByRepMem.pdf](https://www.wto.org/english/tratop_e/scm_e/CV_MeasuresByRepMem.pdf) (accessed September 11, 2020).

**TABLE 3 – SUBSIDIES IN THE WTO AGREEMENT ON SUBSIDIES AND COUNTERVAILING DUTIES (SCM AGREEMENT)**

TYPE OF SUBSIDY	ACTION	EXAMPLES
Prohibited Subsidies	Prohibited	1. Subsidies contingent on export performance ("export subsidies," a detailed list of which is annexed to the SCM Agreement)  2. Subsidies contingent upon the use of domestic over imported goods ("local content subsidies")
Actionable Subsidies	They are not prohibited but subject to challenge in the event that they cause adverse effects (e.g. export displacement) to the interests of another WTO member, either in the market of the subsidizing member or in a third country.	Article 6.3 of the SCM Agreement identifies instances of such serious prejudice to the interests of another member.  This does not include distortion to production capacity.

Source: WTO, Agreement on Subsidies and Countervailing Measures:  
[https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf) (accessed October 10, 2020)

Concretely, the Trilateral Initiative proposes to add four new types of so-called unconditionally prohibited subsidies: "unlimited guarantees, subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan, subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity, [and] certain direct forgiveness of debt."<sup>48</sup>

The proposal also addresses the adverseness of the following types of subsidies: "Excessively large subsidies, subsidies that prop up uncompetitive firms and prevent their exit from the market [so-called zombie enterprises], subsidies creating massive manufacturing capacity without private commercial participation, [and] subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export." The trilateral parties rightly assert that these subsidies should be withdrawn unless members can prove that the measures have been transparently notified and that they result in "no serious negative trade or capacity effects."

In addition, the trilateral partners criticize the findings of the AB that subsidizing entities does not successfully meet the definition of a public body and, as such, that government support did not qualify as WTO-prohibited subsidies.

## RECOMMENDATIONS

The European Commission should undertake more intensive investigations into Chinese subsidies to create the basis for greater application of the EU's anti-subsidy instruments. The EU Commission should evaluate whether or not the burden of proof could be reversed in order to facilitate the implementation of countervailing measures against unfair subsidies. At the same time, companies need to assist the Commission in its efforts by providing empirical evidence and concrete cases.

The proposals of the Trilateral Initiative are well thought out and should thus be discussed at the next WTO Ministerial Conference (MC12) in June 2021. In order to reach consensus on comprehensive reform of the SCM Agreement, the trilateral parties should ramp up efforts to get other member states – such as the other prominent G7 and G20 states – on board with their proposal in the coming months.

In addition, in order to direct countervailing measures properly, the monitoring and reporting of industrial subsidies across sectors needs to be markedly improved. A central, methodologically consistent database of industrial subsidies across various sectors should be compiled by the OECD or WTO.

<sup>48</sup> Office of the United States Trade Representative, "Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union," January 14, 2020: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/joint-statement-trilateral-meeting-trade-ministers-japan-united-states-and-european-union> (accessed August 14, 2020).

### 5.3 Trade Liberalization and the Status of Developing Countries

The EU is disappointed with the negotiating pillar of the WTO, namely the Doha Development Agenda, which has not achieved many tangible outcomes since its start in 2001. At the last MC11 in Buenos Aires in December 2017, then EU Trade Commissioner Cecilia Malmström rightly criticized that WTO members failed to achieve any multilateral outcome.<sup>49</sup> The EU has since looked for alternative ways to update the WTO rule book. Therefore, the MC11 was a breakthrough because members – including the EU – broke with the concept of the single undertaking and opened the way for plurilateral agreements in the areas of e-commerce, investment facilitation, domestic regulation in services, and MSMEs. These plurilateral agreements are the only way forward to negotiate modern trade rules that better reflect today's trade realities.

A related aspect is the definition of developing countries. The WTO has no criteria differentiating between developing and industrialized countries. Rather, members self-determine their development status. Consequently, large emerging economies, such as China, are still treated as developing countries and, thus, benefit from special and differential treatment (SDT). This means, for example, longer periods to phase in obligations and more lenient obligations.

Therefore, in its 2018 concept paper on WTO reform, the EU proposed that members should actively be encouraged to “graduate,” meaning opt-out of SDT. Member states should make it clear where they use the flexibilities and present roadmaps to their end of SDT, i.e. their “graduation.” In addition, the EU wants to make SDT as targeted as possible in future agreements. Instead of block exemptions, it proposes an approach that is needs-driven and evidence-based.<sup>50</sup>

In February 2019, the United States identified four criteria to determine whether WTO members should receive SDT. WTO members who are also members of the OECD or the G20, classified as “high income” by the World Bank, or account for “no less than 0.5 percent of global merchandise trade (imports and exports)” should not qualify as developing countries. Accordingly, WTO members such as China would no

longer qualify.<sup>51</sup> Although the EU and others share the concerns of the United States, the majority of countries saw the US proposal as very confrontational. Unlike the US, the EU is offering a discussion with developing countries on their SDT needs.

## RECOMMENDATIONS

Multilateral approaches, which are global and non-discriminatory in nature, are still the best way forward to level the playing field and foster world trade. Therefore, the EU must facilitate agreement in areas in which multilateral outcomes are possible. The EU should table its proposal on trade and health issues (abolition of tariffs on drugs and medical equipment) at the WTO soon. In addition, the EU must improve its offer with regard to the fisheries subsidies negotiations to achieve a positive outcome at the MC12 next year.

In order to modernize the WTO rule book, the EU should pursue more plurilateral trade topics in addition to the present ones. One important initiative would be the conclusion of the Environmental Goods Agreement (EGA), which was supposed to be finalized in 2017 but failed to reach agreement in the final stages of negotiations. Other areas relate to industrial subsidies (see section 5.2 above), e-commerce, and services trade.

The issue of the development status of countries is also crucial for the working of the entire organization. Because of its history, the EU has a special relationship with many developing countries, particularly in the area of Africa, the Caribbean, and the Pacific (ACP). The EU should increase dialogue with the developing countries on the issue of “graduation” to deal with the SDT issue in a pragmatic and evidence-based way.

<sup>49</sup> European Commission, “WTO Meeting in Buenos Aires: A Missed Opportunity,” December 13, 2017: <<https://trade.ec.europa.eu/doclib/press/index.cfm?id=1772>> (accessed April 21, 2020).

<sup>50</sup> European Commission, “WTO Modernization” (see note 46), pp. 6–7.

<sup>51</sup> Hannah Monicken, “US Proposes Categories to Prevent WTO Self-designation as Developing,” *Inside US Trade*, February 15, 2019: <<https://insidetrade.com/daily-news/us-proposes-categories-prevent-wto-self-designation-developing>> (accessed April 20, 2020).



#### 5.4 WTO Notification and Monitoring

The fourth pillar of the WTO is the monitoring function. In order to achieve transparency, members are regularly reviewed under the Trade Policy Review Mechanism (TPRM). The frequency of these reviews depends on the country's share of world trade. The notification of subsidies – as foreseen in the SCM Agreement – is one prerequisite for a transparent TPRM.

The United States has continually criticized that WTO members – particularly, China – have not fulfilled their notification requirements. Therefore, they introduced a transparency and notification proposal at the WTO Council on Trade in Goods in 2018, which was co-sponsored by the EU, Japan, and others. One of the main elements of the proposal is the idea of possible counter-notifications.

The EU also addresses the problem of transparency and notification in its concept note of September 2018. First, the EU suggests that all WTO committees that oversee notification obligations on trade in goods should evaluate how to make the notifications more effective. This could include allowing the Secretariat to make qualitative assessments on the notifications. Second, the EU proposes to give assistance to small and developing countries to help with notifications. Third, the EU wants to work with other WTO members to enforce notification compliance. The EU is considering the use of sanctions (e.g. limiting certain rights related to WTO processes) to punish continuous non-compliance. Fourth, the EU wants to cooperate more with like-minded members to work on counter-notifications. Lastly, the EU wants to increase peer pressure through the TPRM.<sup>52</sup> It is also pushing for these reforms together with the United States and Japan in the Trilateral Initiative.

The EU's analysis and concerns – in tandem with the United States and Japan – are valid. Notification requirements need to be strengthened to allow the WTO to provide more transparency. The proposals for a stronger role for the Secretariat to assess the quality of the notifications are therefore important. Also, the assistance to small and developing countries is long overdue.

## RECOMMENDATIONS

The crucial aspect in the notification of subsidies is the idea of counter-notifications, which could improve the overall transparency of trade policy. The cooperation between the European Union and the United States in this field is therefore important. Both should enhance these practices to improve transparency.

A complicated aspect is the idea of sanctions to enforce compliance. Many WTO members are opposed to this approach. In order to improve and reform the monitoring pillar and to gather the necessary support from other member states, it is advisable to first focus on more widely accepted ways to increase notifications – such as quality assessments of notifications, requirement to explain reasons, etc. – and, at least for now, to leave sanctions out of the discussion.

<sup>52</sup> European Commission, "WTO Modernization" (see note 46), p. 4.



## 6. CONCLUSION

The geo-economic and geopolitical environment is changing and the EU has to adapt. The EU needs to act more assertively and use the economic weight of the internal market to defend and promote European interests and values. The European Commission thus rightly initiated a trade policy review.

At the same time, the concept of Open Strategic Autonomy poses some danger. Protectionist sentiments have been on the rise in the European Union for years. Thus, it is also not surprising that most of the debates around Open Strategic Autonomy focus on the defensive side of trade policy. There is little discussion about the bilateral and multilateral dimension of EU trade policy – not only in the wider public but also increasingly in political circles in many EU member states. Merely focusing on the defensive, however, would be short-sighted. The EU should use its combined impact to simultaneously level the playing field and uphold the rules-based trading system by focusing its trade policy review on all three dimensions of EU trade policy.

**The Unilateral (EU) Dimension:** To settle trade disputes effectively in times of a deadlocked multilateral dispute settlement body, the EU needs to amend its Enforcement Regulations. The newly established post of Chief Trade Enforcement Officer can also help strengthen the position of the EU vis-à-vis third countries. In the light of the 2018 reform, the EU does not need to overhaul its Antidumping Regulation. The instrument should, however, be further streamlined, and more assistance could be granted to SMEs. To counter subsidies abroad, antidumping and countervailing procedures should more often be pursued in parallel. In particular, the EU needs to strengthen its countervailing instrument. The same holds true for the Union's ability to open up government procurement markets abroad. The proposed IPI is a step in the right direction. While trade can be a powerful instrument to improve environmental and labor standards in trading partners – in particular through bilateral and plurilateral trade agreements – unilateral instruments such as Carbon Border Adjustments must be WTO compatible to minimize the risk of severe trade distortions and retaliations from trading partners.

**The Bilateral Dimension:** Bilateral and regional trade agreements have long been a strong second pillar of the European Union's trade policy, the most ambitious being the ones with Canada and Japan. In or-

der to preserve and increase the EU's leverage in FTAs, the cohesion of EU member states is crucial. It is also important that the negotiated agreements are ratified and implemented in a much more timely manner. To improve the ratification process, the EU's strategy to negotiate agreements that fall into the exclusive competence of the EU is the right way forward. Last but not least, in order to improve the utilization rate of FTAs, the EU should negotiate simple and standardized rules of origin. EU trade agreements should also reflect the increasing importance of digital trade.

**The Multilateral Dimension:** At its core, the European Union is multilateralist. Today, the WTO is in deep crisis. Reforming the WTO must therefore remain a top priority. The most pressing issue is reestablishing a functioning dispute settlement system. The MPIA is an important step in upholding the rules-based trading system – but it is only a temporary solution. Together with the United States and Japan, the EU has proposed to strengthen the rules on subsidies. If a multilateral agreement is out of reach, the EU should push for a plurilateral accord. Plurilateral agreements – such as those currently negotiated on digital trade, services, investment, and MSMEs – are a viable option to advance the global trade rule book. Last but not least, the EU needs to double its efforts to encourage emerging market economies such as China to “graduate” and opt-out of the special and differential treatment options.

The EU is on the right track, but the coronavirus pandemic has made the reform of European trade policy even more urgent. This relates to all three dimensions of trade policy. If the EU succeeds, it will be able to reassert itself as a global player in trade and investment. This, however, will only be possible if the EU member states show more unity in trade policymaking.



Advancing foreign policy. Since 1955.

Rauchstraße 17/18  
10787 Berlin

Tel. +49 30 254231-0

[info@dgap.org](mailto:info@dgap.org)

[www.dgap.org](http://www.dgap.org)

[@dgapev](#)

*The German Council on Foreign Relations (DGAP) is committed to fostering impactful foreign and security policy on a German and European level that promotes democracy, peace, and the rule of law. It is nonpartisan and nonprofit. The opinions expressed in this publication are those of the author(s) and do not necessarily reflect the views of the German Council on Foreign Relations (DGAP).*

**Publisher**

Deutsche Gesellschaft für  
Auswärtige Politik e.V.

ISSN 1611-703

**Editing** Helga Beck

**Layout and Info Graphics**

Luise Rombach

**Design Concept** WeDo

**Author Photo(s)**

Claudia Schmucker © DGAP,  
Stormy-Annika Mildner © BDI



This work is licensed under a Creative Commons  
Attribution – NonCommercial – NoDerivatives 4.0  
International License.